

HOUSE BUDGET COMMITTEE

Democratic Caucus

The Honorable John M. Spratt Jr. ■ Ranking Democratic Member

B-71 Cannon HOB ■ Washington, DC 20515 ■ 202-226-7200 ■ www.house.gov/budget_democrats

July 25, 2002

Members' Budget Packet for the District Work Period: Squandered Surpluses, Broken Promises

Dear Democratic Colleague:

The House Budget Committee Democratic staff has prepared the attached packet about the budget for your use during the August district work period. In the 18 months since Republicans took the White House, we have witnessed the largest fiscal reversal in our nation's history. In January 2001, the budget picture featured record surpluses, a path to paying off the national debt, and an opportunity to strengthen Social Security for the long term. Just a year and a half later, the Republican budget calls for large deficits, increasing public debt, and spending \$2.0 trillion of the Social Security Trust Fund surplus – even according to the Administration's overly optimistic budget numbers.

In August, the Congressional Budget Office will be issuing its updated budget projections. In the meantime, this packet of materials provides a comprehensive, up-to-date assessment of where key budget issues stand. The major points are summarized below. With each point, there are references to the documents in the package that provide more detailed treatments of individual topics.

- ***Republican Budgets Have Turned Persistent Surpluses Into Chronic Deficits*** — In January 2001, both the Congressional Budget Office (CBO) and the Administration's Office of Management and Budget (OMB) projected total surpluses totaling \$5.6 trillion for 2002-2011. Just last week, OMB projected unified deficits for the next three years, and a ten-year unified surplus of only \$444 billion, a decline of \$5.2 trillion in just 18 months. *For more details, see "Analysis of OMB Mid-Session Review."*
- ***Republicans Have Given Up on Protecting Social Security*** — Last year, the President and House Republican leaders repeatedly reaffirmed the bipartisan commitment to protect every penny of the Social Security Trust Fund surplus. But according to its own numbers, the Administration's budget will now spend at least part of the Social Security surplus every year for the next decade, dissipating \$2.0 trillion over 2002-2011. The text of the Administration's July budget report is totally silent on the subject of addressing Social Security's challenges. *For more details, see "Republicans Have Fallen Silent About Social Security" and "In Their Own Words: Verbatim Quotes About the Budget."*

- ***Republicans' Optimistic Numbers Obscure the Full Extent of the Budget Problem*** — As bad as the Administration's most recent budget report looks, it is based on a number of assumptions that are implausibly optimistic. OMB's revenue projections are highly rosy, and the budget omits or minimizes the cost of policies that the Administration supports. Just two days after the Administration released its Mid-Session Review of the budget, Goldman Sachs characterized the Administration figures as being "far too optimistic," perhaps by as much as \$800 billion. *For more details, see "Wall Street Assesses the Administration's Latest Budget Projections," "Rosy Revenue Assumptions Help Administration to Hit Its Fiscal Targets," and "The Hidden Tax Agenda."*
- ***Republicans Try to Shift the Blame for Their Budget Policies*** — Republicans claim that responsibility for the deterioration of the budget should be assigned primarily to the costs of September 11 and the recession. But spending for the war on terrorism and homeland security is likely to account for only about \$600 billion (12 percent) of the decline in the ten-year surplus, far less than the \$1.5 trillion cost of last year's Republican tax cut. *For more details, see "Tax Cut – Not September 11 – Is the Primary Cause of Budget Deterioration."*
- ***Republicans Deny the Problem and Propose More Tax Cuts that Deepen Deficits*** — Last year, the Republican budget left no margin for error, despite Democratic warnings that costly Republican tax cuts might drive the budget back into deficit. And even after the deterioration of the budget, this year's House Republican budget resolution called for an additional \$27.9 billion in tax cuts over the next five years, a total that the House has already exceeded by more than \$15 billion. Meanwhile, the Administration's budget calls for \$541 billion in tax cuts over the next ten years on top of the tax cuts already signed into law. *For more details, see "The Hidden Tax Agenda."*
- ***Republicans Abandon Plans to Pay Off National Debt*** — In early 2001, the Administration announced that the federal government would pay down all the public debt it could by 2008. In fact, Republicans argued that we faced a danger of paying off too much public debt. At the time, there was a bipartisan consensus to pay down the public debt in order to strengthen the economy, prepare for the retirement of the Baby Boom generation, and reduce interest costs. However, the Administration's July 2002 Mid-Session Review of the budget tells a different story. Even taking into account a host of optimistic assumptions, the Administration projects that the nation's debt will be *higher* at the end of 2007 than it was at the end of 2001. *For more details, see "Paying Down the Public Debt: The Missed Opportunity."*

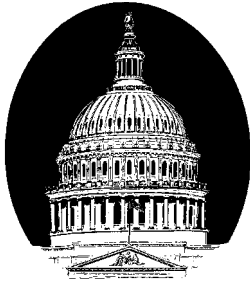
On the next page, the table of contents lists all of the documents included in this packet. A useful set of budget charts also is included. For your convenience, these charts and all of the attached documents can be found at our website: www.house.gov/budget_democrats. Please do not hesitate to contact me or the House Budget Committee Democratic staff with any questions.

Sincerely,

John M. Spratt, Jr.
Ranking Democratic Member

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July 25, 2002

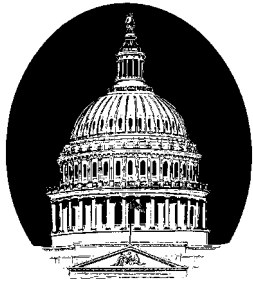
Republicans Have Fallen Silent About Social Security

OMB's Mid-Session Review of the budget released in July contains no plan to start preparing for Social Security's fiscal challenges when the Baby Boom generation begins retiring six years from now.

In its most recent budget update, the Administration claims that the budget is on the right track because OMB projects a small unified budget surplus in 2005. ***Excluding Social Security, though, the Republican economic plan shows deficits and spends the Social Security surplus every year for the next ten years and beyond.*** If one excludes Social Security from the budget numbers, as Democrats believe one should, the ten-year deficit is \$2.0 trillion. That represents more than three-fourths of Social Security's ten-year surplus that is borrowed to fund other purposes.

- ***The Administration's most recent budget projection drops its prior promises to protect and strengthen Social Security.*** Gone is the Republican commitment to last year's bipartisan agreement to protect the Social Security surplus. Gone too is last year's Republican claim that there was a danger of paying off too much debt. Now, the last line of the last page of the Mid-Session Review shows that the Administration acknowledges that the public debt — under its own policies and using its own numbers — will be higher five years from now than it is today. The budgetary resources that debt reduction might have freed up to strengthen Social Security for the long haul have disappeared.
- ***Republicans have stopped talking about their plan to privatize Social Security.*** Last December, the President's Social Security privatization commission declared that this year should be devoted to debating reform options. Now, Republicans have fallen silent about even their own proposals ever since the dramatic drop in the stock market. Nowhere in the Administration's budget documents can one find the roughly \$1 trillion needed to make the transition to such a privatized system, and nowhere is there any mention of the cuts to traditional benefits that stock market returns would supposedly replace.

- ***The Administration's budget documents have never recognized the huge and inescapable budget costs of moving to a privatized system.*** Before, the Administration might have claimed that the surplus could be used to pay the \$1 trillion transition to private accounts. Now, though, the surplus is gone. In fact, since February 2001, projected interest on the public debt for 2002-11 has shot up by \$1.15 trillion — by itself wiping out enough money to shore up Social Security for years to come.
- ***Private stock market accounts do not offer a painless solution to Social Security's impending fiscal challenges.*** The 45 percent decline of the S&P 500 since September 2000 has shown that stock prices do not rise inexorably. Recent developments have made quite vivid the way that a market slump can overthrow years of planning for near-retirees — even if their nest-eggs have earned a positive rate of return since first invested years ago. In fact, the sudden drop in the value of private savings recently is a good illustration why a government-guaranteed defined benefit program should be part of a diversified approach to retirement planning.
- ***The Administration's implausible budget projections understate the degree to which its policies tap the Social Security Trust Fund surplus.*** OMB's overly optimistic budget projection, which shows only a \$175 billion deterioration of the ten-year outlook since February, is not credible. The projection is based on a variety of rosy assumptions, most notably that tax receipts will rebound strongly and show above-average growth. The Administration acknowledges that the stock market's decline in 2001 caused the sharp drop in revenues this year when 2001 taxes were filed. But, OMB ignores the fact that the drop in the market this year will similarly hurt tax receipts next year or thereafter. If, instead, OMB had reported more realistic budget numbers, the invasion of the Social Security Trust Fund surplus would be even greater than the \$2.0 trillion the Administration admits.
- ***Republicans must not walk away from the nation's long-run fiscal challenges.*** Republicans promised that we could have it all: \$2 trillion in tax cuts, more money for defense, funding for domestic priorities like education and prescription drugs, more than enough to pay off the public debt — and still have money left over to strengthen Social Security for the long term. Those promises have been broken. It is past time for Republicans to join with Democrats to put the budget back on a path that will strengthen Social Security.



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July 18, 2002

Wall Street Assesses the Administration's Latest Budget Projections

Dear Democratic Colleague:

I thought that you might appreciate seeing the reaction of Goldman Sachs to the Administration's Mid-Session Review of the budget. The Mid-Session Review portrays the return of deficits as temporary. However, Goldman Sachs, one of Wall Street's most respected investment houses, believes that we now face a far more significant, long-term deficit problem.

We regard the Bush Administration's updated budget forecast profile as being still far too optimistic. While their estimate for the fiscal 2002 budget balance has moved to match ours, at a \$165-billion deficit, the official view regarding fiscal years 2003-2007 combined is for a small surplus, whereas we project a deficit of nearly \$800 billion.

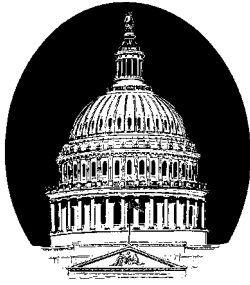
The official budget forecasts in our opinion make overly aggressive assumptions on both sides of the ledger. They reflect a swift rebound in tax receipts, which appears very improbable, particularly in light of recent market developments. Moreover, the Administration forecasts presume that spending growth can be held well below the rate of increase in the nominal economy, which is highly unlikely given that key restraint mechanisms have collapsed.

Goldman Sachs US Daily
Official Budget Balance Forecasts Still Much Too Optimistic
July 17, 2002

In about a month, the Congressional Budget Office (CBO) will release its mid-year update of the budget outlook, which will give the Congress another point of reference. However, we must bear in mind that the financial markets are key arbiters of the credibility of budget forecasts.

Sincerely,
John M. Spratt, Jr.
Ranking Member

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July 25, 2002

Rosy Revenue Assumptions Help Administration Hit Its Fiscal Targets

In its Mid-Session Review of the budget, the Administration claimed that its economic plan will hit two important fiscal targets: (1) the unified deficit will be smaller in 2003 than it is this year and (2) there will be a small unified surplus in 2005. The Administration's prediction relies on an assumption that Federal revenues will increase at an implausibly rapid rate, with especially large jumps in 2003 and 2005. OMB employs three highly questionable assumptions that boost its revenue projections:

- First and most important, the Administration appears to expect a prompt and strong rebound on Wall Street that will boost tax collections on capital gains, stock options, and executive bonuses.
- Second, OMB has reversed its earlier assumptions about the share of non-taxable items (like employee health benefits) in GDP.
- Finally, the Administration presumes historically large jumps in corporate profits will occur just when it needs them to hit its fiscal targets in 2003 and 2005.

Even taking OMB's rosy revenue projections at face value, the ten-year unified budget surplus has plummeted from \$5.6 trillion 18 months ago to \$0.4 trillion today. Even the rosy estimates result in a \$2.0 trillion invasion of the Social Security surplus. Using more credible assumptions, the reported \$5.2 trillion budget deterioration could easily be a half trillion dollars worse. Recognizing all the costly priorities that the Administration claims to care about but does not include in its budget numbers — fixing the alternative minimum tax, extending popular expiring tax provisions, the President's professed commitment to increased foreign aid and quality education, strengthening Social Security — would widen the deficit by trillions more.

Having Bet the Budget on the Stock Market and Lost, The Administration Is Poised to Do It Again

OMB Director Daniels emphasizes in the Mid-Session Review that the sagging stock

market had a severe impact on revenues this year. Withheld taxes, which come from employee paychecks, seem to have tracked GDP and employment as expected. However, taxes that are not withheld — and which reflect in large part capital gains, stock options, and executive bonuses — have slumped along with the stock market.

Director Daniels claims that the fall-off of taxes related to the stock market was unexpected, declaring, “No one, as far as I know, really saw this coming.” However, House Budget Committee Democrats published reports — both before last year’s big tax cut (March 12, 2001) and after (December 13, 2001) — specifically warning that the inflated stock market was boosting budget projections of large surpluses, perhaps unsustainably.

The slump in revenues this year should have been no surprise for one reason: Tax collections each April reflect tax liabilities incurred the year before. *That means that a sagging stock market in one year affects tax receipts from capital gains, stock options, and executive bonuses in the following year.*

The table below shows this lagged relationship between the stock market and revenues. The large stock market increases in calendar years 1997, 1998 and 1999 pushed up revenues to the Treasury in fiscal years 1998, 1999, and 2000, respectively. When the market flattened in 2000, posting an increase of only 7 percent for the year, that plus the slowing economy caused revenues to fall slightly in 2001. Then, the market in 2001 averaged 16 percent below its 2000 level, and tax receipts this April sank, pushing down estimated revenues for 2002 by 6.23 percent, or \$124 billion.

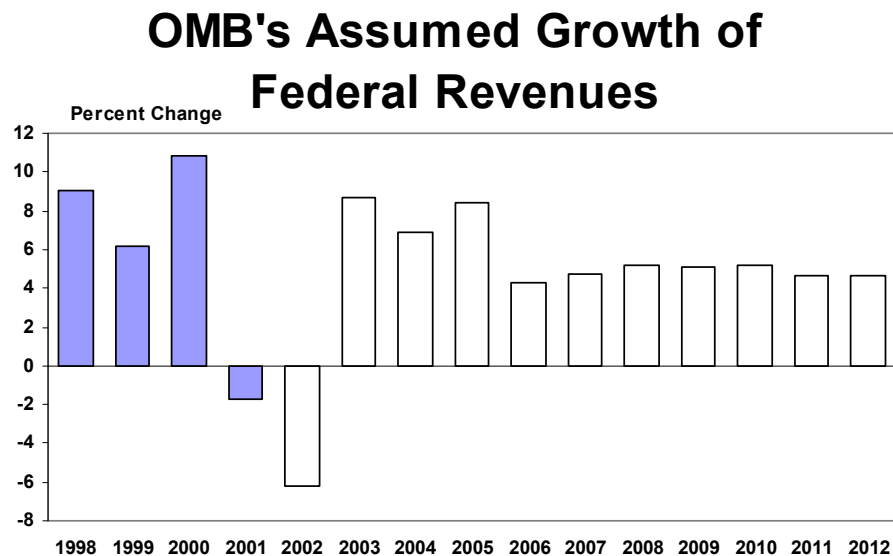
The Stock Market Affects Revenues with a Lag

Fiscal Year	Change in Revenues	Change in S&P 500 Annual Average, Preceding Calendar Year
1998	9.02 %	30 % (Calendar Year 1997)
1999	6.14 %	24 % (Calendar Year 1998)
2000	10.82 %	23 % (Calendar Year 1999)
2001	-1.69 %	7 % (Calendar Year 2000)
2002 estimated	-6.23 %	-16 % (Calendar Year 2001)
2003 projected	8.68 %	?
2004 projected	6.90 %	?
2005 projected	8.39 %	?

The Administration goes to great lengths to note how it now recognizes its mistake. However, having failed to recognize the precariousness of surpluses premised on stock market performance in the past, the Administration’s new projections repeat the very same mistake.

As shown in the chart below, OMB foresees revenue growth over the next three years rivaling the best years of the late 1990s. Over the next three years, OMB assumes revenue growth will average 8.0 percent, only a bit below the 8.6 percent average for 1998, 1999, and 2000. These growth rates exceed the 7.0 percent pace averaged for the 1990s as a whole, for the 1980s, and for the last half century.

This forecast of an abrupt recovery to above-average revenue growth is hard to accept given the stock market's low level at present. In order for this year's market average to exceed last year's, it would require an extraordinary stock market recovery in the next five months.



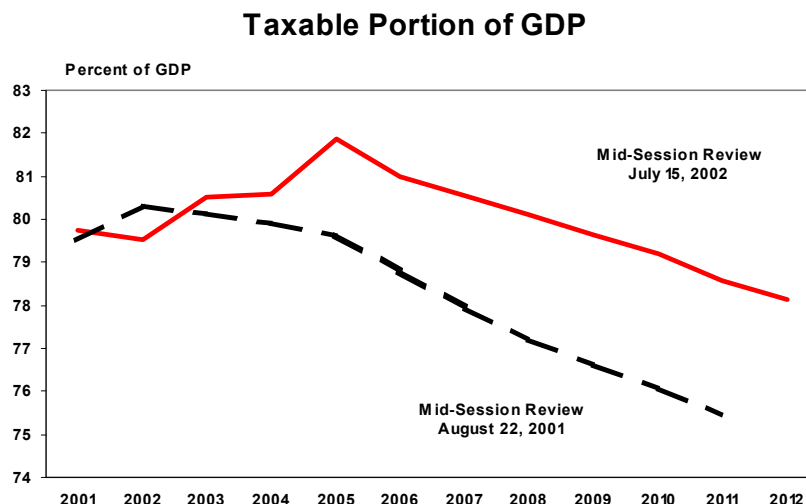
Even if the S&P 500 rose in a straight-line fashion to a level more than double its current value by the end of the year, its 2002 average would merely match the 2001 average. If instead the S&P 500 stayed at its current depressed level for the remainder of the year, the 2002 average would be 20 percent below last year. In this event, the revenue shortfall next year due to depressed income from capital gains, stock options, and executive bonuses might be as large as the one this year.

Of course, withheld taxes from employees' paychecks will presumably grow if earnings and employment recover as the Administration projects, offsetting some revenue weakness due to the sagging stock market. OMB now assumes that GDP in every year of the next decade will be higher than it assumed just five months ago. But even if this forecast is born out, withheld tax receipts probably would not outweigh a significant revenue decline associated with a weaker stock market, just as it failed to do so this year. After all, personal income rose a surprisingly strong 4.9 percent in 2001 despite the recession, but overall revenues still fell 6.23 percent, or \$124 billion, when 2001 taxes were filed this year.

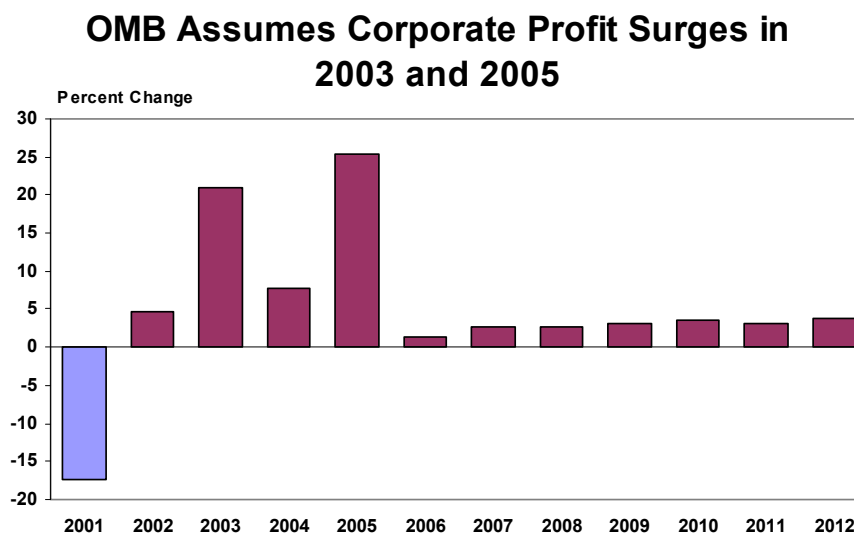
The Administration's Dubious Assumptions About Non-Taxable Income and Surging Corporate Profits in 2003 and 2005

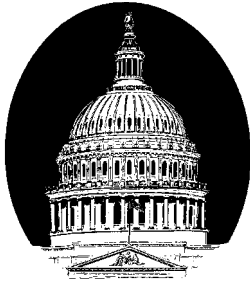
OMB also makes a rather questionable assumption about the total share of income subject to tax between now and 2005. A year ago, OMB assumed that the portion of GDP

subject to tax would fall steadily over the next decade. In large part, this was due to the expectation that rising health care costs probably will push up the share of compensation that employees receive as health benefits, which are not taxed. Now, just five months later, the Administration predicts that the taxable share of GDP will jump between now and 2005 and remain above its earlier prediction thereafter. This assumption seems strange in light of the recent acceleration of health care cost increases.



One of the reasons why the Administration foresees a higher taxable share of GDP is that OMB assumes dramatic jumps in taxable corporate profits in 2003 and 2005. According to the Mid-Session Review, corporate profits will soar by more than 20 percent in 2003 and by more than 25 percent in 2005, bracketing a respectable 7.8 percent advance in 2004. This seems speculative, given that profits have jumped by 25 percent or more only three times and by 20 percent or more only six times in the last half century. Here again, the Mid-Session Review assumes consistently stronger corporate profits throughout the next decade than the Administration's February budget forecast.





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July 25, 2002

The Hidden Tax Agenda

The deficit bottom line in the Administration's *Mid-Session Review* (MSR) likely understates the cost of the budget's explicit program — because of rosy economic and technical assumptions. However, the MSR's omission of long-standing Administration priorities, and of unavoidable national priorities, poses at least as much risk to federal fiscal health.

On the spending side, the MSR continues to assume the President's underfunded prescription drug program for the elderly, and an understated baseline for the existing Medicare program; it continues to maintain that the new Homeland Security Department will be cost-neutral; it includes no allowance for inevitable natural disasters, such as hurricanes or floods; and it fails to account for the President's explicit spending increases, such as for foreign aid and the SEC, and his rhetorical support for underfunded priorities, notably education.

Still, the larger omitted agenda is on the revenue side. The Administration proposes \$541 billion of new tax cuts, which is questionable enough with the budget already violating the Social Security Trust Fund surplus for as far as the eye can see. But then there are enormous further tax costs that are almost inevitable, or that the Administration has long-supported, but that are not acknowledged in the MSR. When those costs come due, they will markedly swell the deficit bottom line — as the chart on the next page demonstrates.

Alternative Minimum Tax

Perhaps the clearest, and probably the largest, instance of this problem relates to the individual alternative minimum tax (AMT). The AMT was originally intended to apply only to very affluent taxpayers who used tax shelters to escape most or all of their tax liability. However, key provisions of the AMT are not indexed for inflation, and so the mere passage of time will greatly extend the AMT's reach. By 2012, under the President's policies, the number of taxpayers subject to the individual AMT will grow from the current 2 million to 39 million — 34 percent of taxpayers with positive income tax liability, including almost half of all families with children.

In large part, this is due to the AMT's powerful interactions with the Republican tax cut passed last year. Many taxpayers who might be expecting tax reductions from last year's tax cut will be sorely disappointed when they see those tax cuts taken away by the AMT. The President's own February budget decried this problem (on page 77 of the *Analytical Perspectives* volume).

Pending and Prospective Tax Reduction 2003-2012

New Tax Proposals in Mid-Session Review (OMB)	141
Tax Extenders in Mid-Session Review (OMB)	62
Repeal of 2010 Sunset (OMB)	338
President's Mid-Session Review Subtotal	541
Make Permanent Stimulus Bill Depreciation (JCT)	245
AMT: Extension of 2001 Provision (CBO)	139
AMT: Hold Harmless for 2001 Enacted Tax Cuts (JCT/HBC)	127
AMT Hold Harmless at Current Incidence (HBC)	150 - 250
Other Tax Extenders (CBO)	166
Missing Pieces Subtotal	827 - 927
Grand Total	1,368 - 1,468

The prudent response a year ago, when the President and Congressional Republicans insisted on a trillion-dollar-plus tax cut, would have been to fix the AMT problem up front. However, Republicans instead inserted only a token relief provision — and then made that palliative expire at the end of 2004. The Administration probably assumed that future policymakers would solve the problem out of the revenue bounty they assumed would flow from their supply-side tax cut. (Indeed, both the Administration's FY 2002 budget and the Republican FY 2002 budget resolution made exactly the same assumption regarding the President's proposed but unfunded defense buildup.)

Clearly, the Congress will not allow the AMT to affect so many middle-class taxpayers. Unfortunately, the cost of softening or eliminating the blow of the individual AMT is very high. Merely extending the soon-to-expire provision in last year's enacted tax cut, which would barely begin to address the problem, costs \$139 billion over ten years. Reducing the problem to its dimensions before last year's tax cut — which would allow the affected population to grow ten fold over the next ten years, instead of twenty fold — would cost another \$127 billion. Then, reducing the number of taxpayers affected all the way back to today's levels would add another \$150 billion to \$250 billion — or more.

Tax Extenders

There are other expiring tax benefit provisions — “extenders” — that the budget ignores. The MSR devotes \$62 billion to selective extensions of these provisions, most notably the research and experimentation (R&E) credit. However, CBO estimates indicate that extending the rest of these provisions would cost \$166 billion over the next ten years. The following table shows a partial list of these popular provisions, many of which Congresses and Administrations have extended repeatedly in the past, and will almost certainly extend again.

Examples of Expiring Tax Provisions Ignored in the Mid-Session Review

Tax Provision	Expires	Revenue Cost 2003-12
Rum Excise Tax Revenue to Puerto Rico and Virgin Islands	12-31-01	0.7
Corporate Computer Contributions to Schools	12-31-03	1.3
Depreciation for Business Property on Indian Reservations	12-31-03	3.5
Investment Tax Incentives in Dist. of Columbia	12-31-03	1.7
Deduction for Qualified Education Expenses	12-31-05	21.2
Puerto Rico Business Credits	12-31-05	11.9
Credit for IRA and 401(k)-Type Plans	12-30-06	6.4
New Markets Tax Credit	12-30-07	2.3
Empowerment and Renewal Zones	12-31-09	4.2

Bonus Depreciation

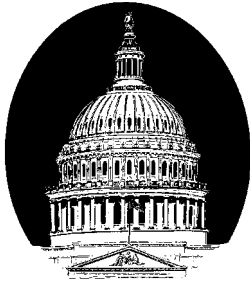
Finally, the MSR is silent regarding the temporary “bonus depreciation” provision of the recent stimulus bill. To provide a quick boost to business investment demand, both Republicans and Democrats favored a temporary liberalization of depreciation deductions. However, the White House, in negotiations leading up to the conference on the bill, argued that the business benefit should not be allowed to expire. For example, Council of Economic Advisers Chair R. Glenn Hubbard said in testimony before the Senate Budget Committee in October of 2001 that “Sound tax policy requires that such expensing be permanent.” Though Democrats generally favored a one-year tax benefit, to increase the inducement to immediate action, Republicans insisted that this provision extend for three years — to expire just before the 2004 Presidential election.

Now, in the MSR, the White House shifts its field to assume that this tax benefit will expire — even though Republicans have consistently argued in other contexts that allowing a temporary tax cut to expire constitutes a “tax increase.” This sudden change of position makes the budget outlook more attractive — especially in light of the Administration’s pledge to bring the budget back to unified balance in 2005. However, given the Administration’s previously emphatic support of a permanent depreciation benefit, and the politically charged expiration date, it seems optimistic to assume that the Administration will stand by while this benefit to business interests expires, just before the election. Congressional estimates indicate that making the bonus depreciation provision permanent would cost another \$245 billion.

More Troubling Implications for the Long Term

The revenue cost of the Administration’s hidden tax agenda could easily approach \$1 trillion over the next ten years — on top of the acknowledged additional tax cuts totaling \$541 billion. But the next ten years is only the beginning. Truly making permanent *all* of last year’s tax cut would drain \$4 trillion from the budget between 2013 and 2022. Permanently repairing the AMT could add even more. Extending the other expiring tax provisions into the second decade of this century, on top of the other newly proposed tax cuts, would only add to this significant cost.

Putting the costs of all these elements of the President’s tax agenda “off the books” jeopardizes our nation’s finances — just as the Baby Boom’s retirement is about to put significant pressures on the budget.



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July 25, 2002

Paying Down the Public Debt: The Missed Opportunity

Just two years ago, there was a firm bipartisan consensus in Washington to pay down — and ultimately to pay off — the public debt. And for good reasons:

- ***Lower Public Debt Means Lower Interest Costs*** — As recently as 1991, the federal government had to spend 18.4 cents of every tax dollar just to pay interest on the public debt. Those interest payments bought absolutely nothing for the American taxpayer. Paying down the debt, and thus bringing down the government's interest obligations, would add enormously to our nation's budgetary strength and flexibility. And it would create opportunities to address the looming demographic pressures on Social Security. Every plan to make Social Security financially sound requires resources beyond the revenues from the existing payroll tax. Members of both parties favored debt reduction because they saw interest savings as resources that could help to save Social Security.
- ***Paying Down the Debt Strengthens the Economy*** — Debt reduction — which means running budget surpluses — adds to the nation's pool of savings. Those savings are then available to private businesses to invest, expanding the size of the economy's productive base and increasing worker productivity. This, too, helps in addressing our number one budgetary and economic challenge: the retirement of the Baby Boom generation.

That is why the Administration claimed with pride in its budget of early 2001 that it would pay down all possible public debt by fiscal year 2008 — even after paying for its tax cuts, financing a prescription drug program for the elderly, reforming education, expanding the defense establishment, and financing the privatization of Social Security.

But the story in the Administration's new *Mid-Session Review* of the budget is dramatically different. Discussions of debt reduction have faded to the background. The Administration now expects to pay \$1.15 trillion more in debt service over ten years (2002 - 2011). And as a result, all discussion of saving Social Security has disappeared.

The reason is clear. On the very last line of the very last page of the *Mid-Session Review* (see next page), the Administration reveals that even with all of the assumed economic growth from its highly touted tax cuts (past and proposed), and even with all of the spending restraint that it unrealistically assumes, the nation's debt will be higher at the end of 2007 than it was at the end of 2001.

The first of the Baby Boomers will begin to claim Social Security benefits in 2008, when they reach 62 years of age. The Administration's *Mid-Session Review* reveals that, with the President's budget plan, we will by that time have accomplished less than nothing to prepare for this momentous economic and budgetary challenge. History may judge this as one of our nation's most important missed opportunities.

Table 20. FEDERAL GOVERNMENT FINANCING AND DEBT

(In billions of dollars)

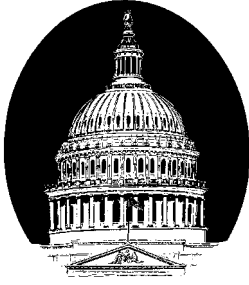
	2001 Actual	Estimate					
		2002	2003	2004	2005	2006	2007
Financing:							
Unified budget surplus (+)/ deficit (-)	127	-165	-109	-48	53	60	84
Financing other than the change in debt held by the public:							
Premiums paid (-) on buybacks of Treasury securities ¹	-11	-4	.....	.....	.....	.....	.....
Net purchases (-) of non-Federal securities by the National Railroad Retirement Investment Trust .....	.....	-6	-11	-*	*	*	*
Changes in: ²							
Treasury operating cash balance	8	-6	-5	.....	.....	-5	.....
Checks outstanding, deposit funds, etc. ³	-13	-12	10	.....	.....	.....	.....
Seigniorage on coins	1	1	1	1	1	1	1
Less: Net financing disbursements:							
Direct loan financing accounts	-19	-15	-15	-15	-15	-15	-15
Guaranteed loan financing accounts	-4	-2	3	3	4	5	5
Total, financing other than the change in debt held by the public	-37	-44	-17	-11	-9	-14	-8
Total, amount available to repay debt held by the public	90	-209	-126	-58	44	47	76
Change in debt held by the public	-90	209	126	58	-44	-47	-76
Debt Subject to Statutory Limitation, End of Year:							
Debt issued by Treasury	5,743	6,155	6,535	6,897	7,195	7,506	7,805
Adjustment for Treasury debt not subject to limitation and agency debt subject to limitation ⁴	-15	-15	-15	-15	-15	-15	-15
Adjustment for discount and premium ⁵	5	5	5	5	5	5	5
Total, debt subject to statutory limitation ⁶	5,733	6,145	6,524	6,887	7,184	7,496	7,795
Debt Outstanding, End of Year:							
Gross Federal debt: ⁷							
Debt issued by Treasury	5,743	6,155	6,535	6,897	7,195	7,506	7,805
Debt issued by other agencies	27	27	26	26	24	24	23
Total, gross Federal debt	5,770	6,182	6,561	6,923	7,219	7,530	7,828
Held by:							
Debt securities held by Government accounts	2,450	2,654	2,906	3,210	3,550	3,908	4,202
Debt securities held by the public ⁸	3,320	3,529	3,655	3,713	3,669	3,622	3,546

* \$500 million or less

¹ Includes only premiums paid on buybacks through April 2002. Estimates are not made for subsequent buybacks.² A decrease in the Treasury operating cash balance (which is an asset) would be a means of financing a deficit and therefore has a positive sign. An increase in checks outstanding or deposit fund balances (which are liabilities) would also be a means of financing a deficit and therefore would also have a positive sign.³ Besides checks outstanding and deposit funds, includes accrued interest payable on Treasury debt, miscellaneous liability accounts, allocations of special drawing rights, and, as an offset, cash and monetary assets other than the Treasury operating cash balance, miscellaneous asset accounts, and profit on sale of gold.⁴ Consists primarily of Federal Financing Bank debt.⁵ Consists of unamortized discount (less premium) on public issues of Treasury notes and bonds (other than zero-coupon bonds) and unrealized discount on Government account series securities.⁶ The statutory debt limit is \$6,400 billion.⁷ Treasury securities held by the public and zero-coupon bonds held by Government accounts are almost all measured at sales price plus amortized discount or less amortized premium. Agency debt securities are almost all measured at face value. Treasury securities in the Government account series are measured at face value less unrealized discount (if any).⁸ At the end of 2001, the Federal Reserve Banks held \$534.1 billion of Federal securities and the rest of the public held \$2,785.9 billion. Debt held by the Federal Reserve Banks is not estimated for future years.

Under the Bush plan, debt at the end of 2007
 → is higher than debt at the end of 2001.

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July 25, 2002

In Their Own Words: Verbatim Quotes About the Budget

“Fiscal responsibility used to be about as common in this town as Halley’s comet, but we put the tax-and-spend century behind us. We are here today to replace it with a century of surplus.”

House Majority Leader Richard Armey
Congressional Record, H1270, February 28, 2001

Republicans Claimed That the Social Security Trust Fund Surplus Would Be Protected

“Inherent in the budget, of course, is our desire to make sure we protect Social Security—I think there is unanimity on the table for that—that we set clear priorities, that we fund the priorities. In our budget, we’re going to prove to the American people that we can pay down debt, fund priorities, protect Social Security, and there will be money left over, which we strongly believe ought to be passed back to the taxpayers.”

President Bush
Remarks to Members of House and Senate Budget Committees, February 15, 2001

“None of the Social Security surplus will be used to fund other spending initiatives or tax relief.”

A Blueprint for New Beginnings: A Responsible Budget for America’s Priorities, Page 11
Office of Management and Budget, February 28, 2001

“We are going to wall off Social Security trust funds and Medicare trust funds . . . And consequently, we pay down the public debt when we do that. So we are going to continue to do that. That’s in the parameters of our budget and we are not going to dip into that at all.”

House Speaker Dennis Hastert
Quoted in BNA’s *Daily Tax Report*, March 2, 2001

Republicans Claimed that Their Budget Left a Margin for Error

“There is not more than enough room for the President’s tax relief plan. There is vastly more than enough room... Being, as I think a banker would look at it, over-reserved against the unknown, we have fully enough money left to give a refund to the American taxpayer... The budget is built on very conservative and cautious assumptions... The revenue relative to GDP numbers are extremely cautious.”

Mitchell Daniels, Director of the Office of Management and Budget
White House Bulletin, February 28, 2001

“We should also prepare for the unexpected, for the uncertainties of the future. We should approach our Nation’s budget as any prudent family would, with a contingency fund for emergencies or additional spending needs . . . And so, my budget sets aside almost a trillion dollars over 10 years for additional needs.”

President Bush
Address to Joint Session of Congress, February 27, 2001

“Tax relief is central to my plan to encourage economic growth, and we can proceed with tax relief without fear of budget deficits, even if the economy softens. Projections for the surplus in my budget are cautious and conservative. They already assume an economic slowdown in the year 2001.”

President Bush
Remarks at Western Michigan University, March 27, 2001

“In sum, there is ample room in the Administration's budget to pay off debt as far as possible, to reduce taxes for American families to fund program priorities, and still leave roughly \$1.0 trillion for Medicare modernization and to meet other programmatic and contingency needs as they arise.”

A Blueprint for New Beginnings: A Responsible Budget for America’s Priorities, Page 13
Office of Management and Budget, February 28, 2001

“There has been considerable public discussion of the potential downside risks to the surplus projections. However, the greatest "risk" to accurate forecasting in recent years has been on the upside as a result of stronger than expected revenue growth and weaker than expected outlay growth. Revenues have contributed most to surplus underestimates . . .”

A Blueprint for New Beginnings: A Responsible Budget for America’s Priorities, Page 14
Office of Management and Budget, February 28, 2001

Republicans Claimed that Their Budget Would Pay Down Maximum Debt

“We owe it to our children and grandchildren to act now, and I hope you will join me to pay down \$2 trillion in debt during the next 10 years. At the end of those 10 years, we will have paid down all the debt that is available to retire.”

President Bush
Address to Joint Session of Congress, February 27, 2001

“This new approach is also responsible: It will retire nearly \$1 trillion in debt over the next four years. This will be the largest debt reduction ever achieved by any nation at any time. It achieves the maximum amount of debt reduction possible without payment of wasteful premiums. It will reduce the indebtedness of the United States, relative to our national income, to the lowest level since early in the 20th Century and to the lowest level of any of the largest industrial economies.”

A Blueprint for New Beginnings: A Responsible Budget for America's Priorities, Page 3
Office of Management and Budget, February 28, 2001

Republicans Had Ample Warning That Their Budget Left No Room for Error and Was Betting the Budget on the Stock Market

“The future is uncertain; and so our budget should always have something in hand, in case outcomes are unfavorable. We learned in the 1980s that betting the budget on an optimistic forecast and speculative policies is unwise. We learned in the 1990s that fiscal discipline works. We know that every day takes us closer to demographic developments whose occurrence is certain, but whose effects are profoundly uncertain. This is no time for another self-indulgent fiscal experiment; we should not rush to undertake *counter-productive* fiscal policy. We should stay with what works, and make allowances for the uncertainties just a few years in the future. That would best serve those who will follow us - a concept that somehow seems somewhat more vivid to me on this particular day.”

OMB Director Jacob J. Lew
Testimony before the Senate Budget Committee, January 19, 2001

“CBO says that its current budget projections may be subject to even greater error than in the past...[saying] ‘The longer-term outlook is also unusually hard to discern at present.’...CBO calculates that there is about a one in five chance that the budget outside of Social Security and Medicare will be in deficit after 2003.”

Budget Talking Points
House Budget Committee Democrats, February 12, 2001

“One of the reasons for the growing budget surpluses over the past few years has been higher capital gains tax revenue as a result of the booming stock market....Mark Zandi, Chief Economist at Economy.com, explains, ‘We’ve had years of stock-juiced surpluses at all levels of government. But a flat equity market will quickly weigh on government’s good fiscal fortunes.’”

Ten-Year Budget Surplus Estimates Are Unreliable
House Budget Committee Democrats, March 12, 2001

“I hope that these blue-sky projections that total some \$5.6 trillion in surpluses over the next ten years will materialize. It will be a great bounty for all of us. But if they do not and if we pass this [budget] resolution, we can find ourselves right back in the red again in the blink of an economist’s eye.”

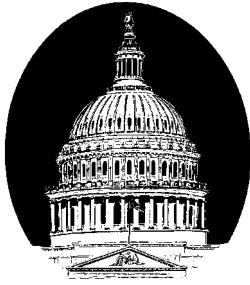
Representative John M. Spratt
Ranking Democrat, House Budget Committee
Congressional Record, March 28, 2001

“CBO’s recent budget re-estimates have shown a similar variation — which means that large re-estimates, perhaps in the opposite directions are possible....Over the past year alone, CBO has increased its surplus projection by \$2.5 trillion. Over the past three years, CBO has increased its surplus projection by almost \$5 trillion....Similar re-estimates could occur again, going in either direction.”

Long-Term Budget Estimates Are Unreliable
House Budget Committee Democrats, May 24, 2001

“There are good reasons to expect that revisions of the surplus in coming months will be negative....[T]he amount of revenue generated by every dollar of GDP is likely to decline sharply in the short run and may not recover much in the long run. The ratio of revenues to GDP had risen to record levels, and until recently both OMB and CBO had assumed that it would retreat only modestly. However, with weaker growth of income tied to the stock market — like capital gains, stock options, executive compensation, and bonuses — the revenue from such sources may well reverse its earlier disproportionate growth. Even small changes in the ratio of revenues to GDP can have major impacts on the budget.”

Republican Stimulus Proposals Make a Bad Situation Worse
House Budget Committee Democrats, December 13, 2001



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July 25, 2002

There's No Free Lunch: Republican Budget Cuts Domestic Appropriations

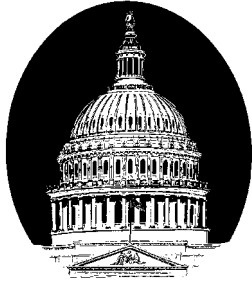
Despite what Republicans would have us believe, there is no free lunch. According to the Republican budget, we can afford to provide the largest military buildup since the early 1980s, double homeland security, add \$541 billion to last year's \$1.5 trillion tax cut, and provide Medicare prescription drug coverage. What the Republican budget does not mention is the ultimate cost – either the cost of the depleted Social Security surplus, or the cost of the important domestic programs that we will not be able to fund.

The Republican budget is based on three unrealistic assumptions: (1) that we will cut domestic appropriations for 2003 by 0.4 percent below this year's level and by 6.0 percent below what is needed to keep pace with inflation; (2) that Congress will cut domestic appropriations each year for the next ten years by at least \$20 billion below inflation; and (3) that Congress will not fund items that the Administration has requested but did not include in its budget.

- ***Republicans Cut 2003 Domestic Appropriations by 0.4 Percent*** — The Administration's Mid-Session Review (MSR) of the budget portrays appropriations outside of Defense and Homeland Security as growing by 2 percent from 2002 to 2003. However, once you subtract international affairs appropriations and add the transportation funding provided by the Appropriations Committee, the Administration is cutting domestic appropriations by 0.4 percent from 2002 to 2003. This is a 6.0 percent cut below the amount that the Congressional Budget Office estimates is needed to maintain purchasing power at the 2002 level. That is unlikely, especially given the Administration's support for increases in certain areas.
- ***Republican Budget Cuts Domestic Appropriations Every Year for 10 Years*** — The budget continues its cuts to domestic appropriations each year for the next ten years. From 2003 through 2012, the President's budget cuts domestic discretionary programs by a cumulative \$269.3 billion below the amount needed to maintain purchasing power at the 2002 level. The budget makes these unrealistic cuts in order to keep the projected deficit from seeming even larger.

- ***Omitted Costs*** — The MSR does not include the cost of numerous items that Congress must address and that the President has said he supports, such as his Millennium Challenge Account foreign aid proposal (\$30 billion over ten years), and an increase in 2003 for the Securities and Exchange Commission (\$100 million above his budget request). The President's increased request, however, is still more than \$150 million below the amount that the Senate Appropriations Committee recently approved.

The Republicans predicate their forecast for a return to unified budget surpluses — still using the Social Security Trust Fund surplus, just not spending all of it each year — based on these three faulty assumptions about domestic appropriations. If Republicans were to use more reasonable funding estimates, they would more accurately predict the true size of future deficits. However, this would require them to acknowledge fiscal reality: we cannot have it all now and later, too. For more information about the Republican budget, please visit our website at www.house.gov/budget_democrats/.



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July 25, 2002

Republicans Underfund the SEC

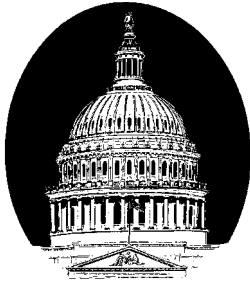
In the wake of the Enron and MCI WorldCom bankruptcies and other corporate scandals, we must do everything we can to ensure corporate accountability and protect employees, shareholders, and consumers. Democrats are concerned that Republican budgets have underfunded the Securities and Exchange Commission (SEC) and thus diminished that agency's enforcement capabilities. To date, the Administration has paid lip service to a strong SEC but has failed to include in its budget the funding needed to create it.

Despite bipartisan agreement that the SEC has not had adequate resources to keep up with its workload, this year's House Republican budget and the President's budget failed to increase funding to hire more staff or to provide the competitive salaries needed to improve SEC staff retention. While the President in July finally spoke in favor of increasing funding for the SEC above his budget request, his proposal falls more than \$150 million below the amount recently approved by the Senate Appropriations Committee.

- ***Republican Budgets Reject Bipartisan Consensus on Pay Parity for SEC*** — Lawyers, accountants, and examiners at federal banking agencies make up to 40 percent more than comparable employees at the SEC. Between 1998 and 2000, the SEC had turnover of about one third of its staff, hindering its performance of critical regulatory functions. In January 2002, the President signed into law legislation authorizing SEC pay parity. SEC Chairman Harvey Pitt has stated his strong support for SEC pay parity, as did the 2003 Views and Estimates for both the Majority and the Minority of the House Financial Services Committee. *Yet, neither the President's budget nor the House Republican budget provided funding for SEC pay parity.*
- ***Budget Committee Republicans Rejected Democratic Pay Parity Amendment*** — In the House Budget Committee markup of this year's budget resolution, Democrats offered an amendment to provide roughly \$70 million per year to fund SEC pay parity. *The amendment was defeated because every Republican member of the Budget Committee voted against it.*

- ***Republican Budgets Fail to Provide Funding to Boost SEC Staffing*** — A March 2002 GAO report concluded that resource limitations have resulted in an SEC staff that is smaller than is needed to keep up with the SEC's workload. SEC Chairman Harvey Pitt has requested additional funding to increase SEC staffing levels, and Republicans and Democrats on the House Financial Services Committee have also requested increased SEC funding. *Yet, neither the President's budget nor the House Republican budget for 2003 provided funding for new SEC staff.*
- ***Recent Administration Proposal Falls Over \$150 Million Short*** — On July 9, the President proposed increasing funding for the SEC above his 2003 budget request. However, his proposed \$100 million increase is still more than \$150 million less than the amount approved recently by the Senate Appropriations Committee.

As the Administration works with Congress to find solutions to the problems of corporate accountability, the Administration needs to provide the SEC with the resources it needs to do its job effectively.



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July 25, 2002

Tax Cut – Not September 11 – Is the Primary Cause of Budget Deterioration

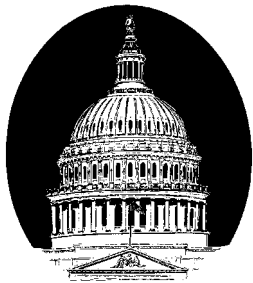
Last week, Mitchell E. Daniels, Jr., Director of the Office of Management and Budget (OMB), testified before the House Budget Committee on the Administration's Mid-Session Review of the budget. His big news was that the ten-year unified surplus has gone from \$5.6 trillion to \$441 billion since Republicans took the White House – a loss of \$5.2 trillion. The projected deficit for 2002 has grown by almost 60 percent since February, from \$106 billion to \$165 billion, and the projected ten-year deficit has grown by \$175 billion since February, causing the government to spend almost \$2.0 trillion of the Social Security Trust Fund surplus over ten years. These numbers would be worse if the Administration were not using implausibly optimistic economic projections.

The Republicans blame this bleak future of deficits not on their huge tax cut of last year but mostly on the cost of responding to September 11. In his opening remarks, Chairman Nussle said, "So the context of today that we find ourselves in is directly related to September 11th..." Director Daniels said, "Nobody told us there would be an attack on September 11th or that it would cost \$21 billion to rebuild New York from it, etc., etc."

The Republican claims are wrong. As shown in the table on page 32, the broadest reasonable total cost of responding to the events of September 11 is less than \$600 billion over ten years (2002-2011), including interest. September 11 thus accounts for less than 12 percent of the total \$5.2 trillion deterioration of the ten-year unified surplus since last year. In contrast, OMB now reports that last year's \$1.5 trillion tax cut accounts for 29 percent of the deterioration of the surplus. Including the additional tax cuts that the Administration is requesting means that the President's total tax agenda accounts for at least one third of the budget's deterioration since he took office, according to his own numbers.

Since the tragedy of September 11, our fiscal situation clearly has changed, but September 11 is not the main cause of our worsening deficit. Despite Republican claims, the tax cut is.

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July 16, 2002

ANALYSIS OF OMB MID-SESSION REVIEW

There are two major causes for concern in the Administration's summer update. First, *the Administration adopts a number of questionable assumptions* and thus produces numbers that are implausibly optimistic. In all likelihood, the true budget picture is even worse than reported in the Mid-Session Review. Second, even taken at face value, *the Administration budget calls for substantial on-budget deficits and thus gives up on its previous promise to protect the Social Security surplus. The Mid-Session Review calls for spending \$1.97 trillion of the Social Security Trust Fund surplus from 2002 to 2011.*

Despite the Administration's claims to the contrary, this dramatic deterioration of the budget picture cannot be primarily attributed to the effects of September 11 and the recession. Spending for the war on terrorism accounts for only 12 percent of the ten-year budget decline, while the Mid-Session Review assumes GDP that will be between \$130 billion and \$240 billion per year higher than that assumed in the President's budget five months ago.

The Administration's Report

- **Ten-Year Picture** — The Administration's summer update shows only a modest \$175 billion downward revision over ten years relative to its February 2002 projection. The 2002-11 unified surplus has declined from the \$5.6 trillion surplus estimate in February 2001 to a \$444 billion post-policy surplus today. The on-budget accounts (that is, excluding Social Security) for 2002-11 have deteriorated from a baseline surplus of \$3.0 trillion in February 2001 to a \$1.97 trillion

From Surplus to Deficit in Non-Social Security Budget

Trillions of Dollars

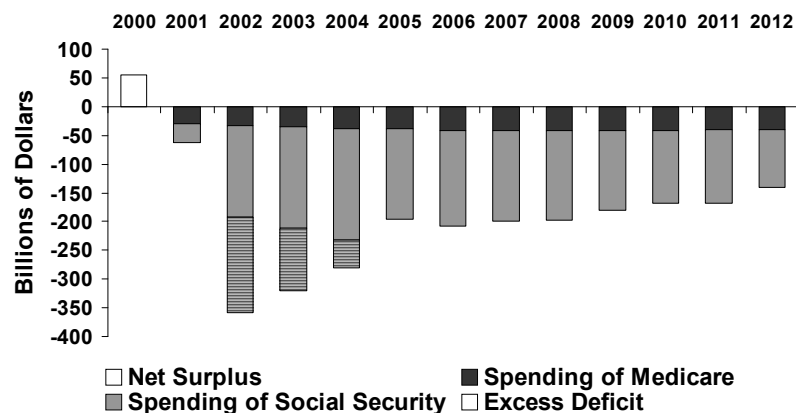
	2002-2011
April 2001	3.046
August 2001	0.575
February 2002	-1.650
July 2002	-1.968

Source: Office of Management and Budget

deficit for the same period. Thus, the Mid-Session Review continues to show an Administration budget that chronically spends the Social Security surplus.

- Year-By-Year Picture** — The Administration projects a unified deficit for 2002 of \$165 billion, revised downward from their February projection of \$106 billion. The Administration claims that the deficit will shrink from \$165 billion in 2002 to \$109 billion in 2003. (By contrast, the Senate Budget Committee Republican staff estimates that the 2003 deficit will increase to \$194 billion.) The Administration asserts that in 2005 the budget will achieve a small surplus (\$53 billion), with growing surpluses thereafter. However, in no year covered by these projections does the Administration project that unified surpluses will be as large as the Social Security surplus, meaning that the Administration's budget will continue to spend the Social Security surplus in every year covered by these projections.

President's Budget Spends Social Security and Medicare



The Administration's Numbers Are Implausibly Optimistic

The small \$175 billion ten-year OMB downward revision of the budget outlook is simply not credible, in light of April's revenue collapse and the recent state of the stock market. OMB's rosy outlook results from a variety of questionable assumptions. (The Administration has made only minor changes in its policy prescriptions.) The overly optimistic economic and technical assumptions mask the true extent of the likely deterioration in the budget outlook. The most notable examples of questionable assumptions that make projected deficits look smaller and projected surpluses look larger are the following:

Economic Assumptions

- Overall Income Tax Receipts** — OMB claims to have provided cautious new revenue estimates, in light of the enormous drag in FY2002 income tax receipts. However, their new numbers are still rosy. Absent the enacted and proposed tax cuts, OMB's projected individual income tax revenues for 2007 are projected to have zoomed right back up to the record level of FY2000. Since the President submitted his budget in February,

- revenues have collapsed, and the stock market has declined. Yet, the Administration assumes that revenues will increase by nearly 9 percent in 2003 and by almost as much in 2004 and 2005. The budget further predicts that total revenues in 2006 through 2012 will be greater than assumed in the President's February budget.
- **Taxable Share of GDP** — In last year's Mid-Session Review, OMB predicted that the taxable portion of GDP will decline over the next decade. CBO's projections have been consistent with this view; this trend results from the assumption that rising health care costs will drive up the portion of income that is not taxed over time. However, this year's Mid-Session Review reverses course, predicting now that the taxable portion of GDP will rise rather sharply between now and 2005 before trending down from that higher level. This means that for most of the ten-year period, OMB is now assuming that the taxable portion of GDP will be hundreds of billions higher than OMB assumed just a year ago.
- **Tax Revenues from Capital Gains** — On Friday OMB Director Mitch Daniels stated that the Administration's projection assumes that tax revenues from capital gains will increase, albeit slowly, from their current level. However, this assumption seems at odds with the facts: capital gains tax receipts next April will be determined by capital gains realizations this calendar year, and the average for the S&P 500 thus far this year is down about 10 percent from its 2001 average.
- **Jump in Corporate Profits** — The Mid-Session Review asserts that the unified deficit will grow smaller in 2003 and will reach balance in 2005. The Mid-Session Review also assumes that corporate profits will jump by more than 20 percent in 2003 and by more than 25 percent in 2005. In the last half century, there have been only three years when corporate profits have jumped by more than 25 percent and only six years when they increased by more than 20 percent.

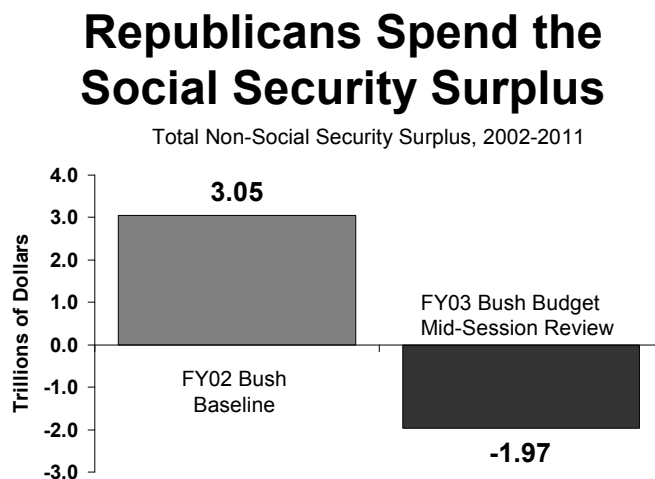
Understated Costs

- **Medicare Baseline** — The Mid-Session Review ten-year baseline projections for Medicare spending continue to be lower than CBO's baseline projections. The Mid-Session Review projections show some increase in baseline Medicare spending but are still \$173 billion below CBO's March 2002 projections for the same period.
- **Understated Prescription Drug Costs** — The Mid-Session Review bases its numbers on a figure of \$190 billion for Medicare prescription drugs, despite the Administration endorsement of the \$350 billion bill passed by House Republicans.
- **Unrealistic Cuts to Discretionary Spending** — At first glance, the Mid-Session Review shows appropriations outside of Defense and Homeland Security growing by 2 percent from 2002 to 2003. However, a true picture of domestic appropriations requires subtracting international affairs spending and adding the transportation obligation limitations provided by the Appropriations Committee. When these numbers are included, it is apparent that the Administration arrives at its apparently smaller deficit

- number for 2003 only by assuming a nominal cut of 0.4 percent in domestic appropriations. In light of the President's proposals for increases in foreign assistance, education, health research, and the SEC, such a cut in total domestic spending is not plausible.
- **Other Omitted Costs** — The Mid-Session Review does not include the cost of numerous other items, including: a fix for the Alternative Minimum Tax (AMT); the Administration's February proposal to make permanent the three-year bonus depreciation contained in the stimulus bill; an extension of popular tax provisions due to expire in the next few years; the roughly \$1 trillion needed to fund the transition costs of the President's proposal to privatize Social Security; the cost of natural disasters; and the roughly \$30 billion cost of the President's Millennium Challenge Account foreign assistance proposal.

The Administration's Budget Has Given Up on Protecting Social Security

- **By Administration's Own Numbers, \$1.97 Trillion Spent from Social Security Surplus** — Last year, the President and House Republican leaders reaffirmed their promise to protect every penny of the Social Security Trust Fund surplus. Indeed, last year's Mid-Session Review highlighted this pledge by placing it on page 1 and page 2 of the report. One year later, the report contains no discussion of this promise. The numbers contained in the update reveal why. Even taken at face value, the Administration's budget shows a chronic invasion of the Social Security Trust Fund. The Social Security Trust Fund surplus is more than consumed by on-budget deficits through 2004, and it is partially consumed throughout the ten-year projection. The Administration's budget, taken at face value, consumes \$1.97 trillion of the Social Security Trust Fund surplus from 2002-11.
- **Administration Chooses More Tax Cuts Over Protecting Social Security** — Despite the clear deterioration of the budget picture since February 2001, the Administration continues to push for additional tax cuts, even though these tax cuts mean deeper invasions of the Social Security Trust Fund. Indeed, this Mid-Session Review proposes over \$500 billion in new tax cuts over ten years.

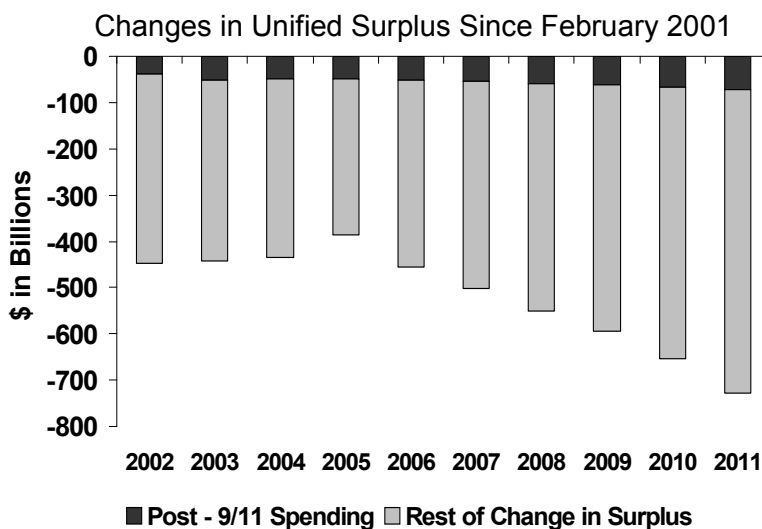


- **True Picture Likely to Be Much Worse** —As discussed in the previous section, there are numerous reasons to suggest that the Administration’s budget outlook is overly optimistic. A more realistic projection of the items noted above would likely show an Administration budget with worse deficits and deeper spending of the Social Security surplus.

September 11 and Recession are not the Primary Cause of the Budget Deterioration

- **September 11 About One-Third the Impact of the Tax Cut** — When the Administration assumed office, the unified surplus over the 2002 - 2011 period was \$5.6 trillion. OMB now estimates it to be \$444 billion, a decrease of \$5.2 trillion. As discussed in detail below, the broadest reasonable definition of the total cost of September 11 would reach about \$600 billion, including interest. In comparison, the 2002-2011 cost of the enacted Bush tax cut, including interest, is \$1.5 trillion according to OMB’s latest estimate (and the President now proposes another \$541 billion of tax cuts, not including interest, over 2003-2012). While significant, the total incurred and projected cost of September 11 pales in comparison to the Bush tax cuts. September 11 accounts for less than 12 percent of the total deterioration of the surplus, while the enacted tax cut alone accounts for 29 percent.

Gauging the Impact of September 11:



- **The Cost of September 11 Is Approximately \$600 Billion** — The cost of September 11 includes the \$40 billion emergency spending bill enacted in the aftermath, the airline bailout bill, the USA PATRIOT Act, and the victims compensation bill. It also assumes enactment of the 2002 supplemental; the doubling of homeland security funding above pre-September 11 levels; establishment of the Department of Homeland Security (H.R. 5005); and the Pentagon’s cost of conducting the war on terrorism at more than \$20 billion per year. This last assumption could easily prove overly pessimistic, as operations in Afghanistan are already slowing. If so, the ultimate cost would come in lower. These costs are detailed (outlays only) in the attached table and include interest costs as well.

Measuring the Cost of September 11
Outlays in Billions of Dollars
OMB Estimates Used Unless Noted Otherwise

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>Ten-Year 02-11</u>
Enacted Legislation												
\$40 Billion Emergency Supplemental (PL 107-38 and 107-117)*	0.2	24.4	8.0	4.0	2.0	0.8	0.3	0.2	0.0	0.0	0.0	39.7
Air Transportation Safety and System Stabilization Act (PL 107-42)	2.6	5.2	4.5	1.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	11.5
USA PATRIOT Act (PL 107-56)	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.3
Victims of Terrorism Relief Act (Revenue Reductions) (PL 107-134)*	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.3
Pending Legislation	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>Ten-Year 02-11</u>
FY 2002 Supplemental (House-passed)**	0.0	7.0	12.9	4.8	2.5	1.4	1.1	0.4	0.1	0.0	0.0	30.2
FY 2003 DoD War on Terrorism***	0.0	0.0	13.4	18.3	20.1	21.0	21.7	22.2	22.8	23.4	24.0	186.9
Increase in Homeland Security (Beyond pre-Sept 11 levels)****	0.0	0.0	10.5	14.2	16.1	17.1	17.7	18.1	18.5	19.1	19.5	150.7
H.R. 5005** (not already included in President's request)	0.0	0.0	0.1	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	2.2
Subtotal, Policy Changes	2.8	36.9	49.6	43.3	40.9	40.6	41.0	41.2	41.7	42.8	43.7	421.8
Interest on Changes**	0.0	0.5	2.9	5.9	8.6	11.4	14.2	17.3	20.5	23.9	27.6	132.8
Total Projected Cost of September 11	2.8	37.4	52.5	49.2	49.6	51.9	55.3	58.5	62.2	66.7	71.3	554.6

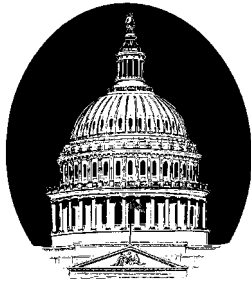
*OMB scoring does not cover full period; projection for remainder.

**CBO scoring.

***Based on Administration estimate of \$20.1 billion in BA for 2003. BA assumed to keep pace with inflation thereafter. Generic outlay rate assumed.

****Based on data provided by OMB.

House Budget Committee Democratic Staff – July 15, 2002.



HOUSE BUDGET COMMITTEE

Democratic Caucus

The Honorable John M. Spratt Jr. ■ Ranking Democratic Member

B-71 Cannon HOB ■ Washington, DC 20515 ■ 202-226-7200 ■ www.house.gov/budget_democrats

July 24, 2002

Frequently Asked Questions About the Federal Budget

The following pages use the most recent data available to answer many frequently asked questions about the budget.

1. What is the projected total U.S. budget for FY 2002?

According to March CBO figures (including the impact of the economic stimulus legislation), federal government spending (including Social Security) is projected to be \$2.010 trillion. “On-budget” spending, which excludes Social Security, is estimated to be \$1.649 trillion. Net “off-budget” spending, primarily Social Security, is estimated to be \$361 billion.

Major Categories of Spending - Estimated FY2002 Outlays Percentage

	<u>Dollar Amount</u>	<u>Federal Budget</u>
Discretionary spending:		
Defense	\$348 billion	17 percent
Non-Defense	\$383 billion	19 percent
Entitlements and other “mandatory” except net interest:		
Social Security benefits	\$453 billion	23 percent
Medicare (net of premiums)	\$223 billion	11 percent
Medicaid	\$146 billion	7 percent
Other (e.g., Civil Service and Military Retirement, SSI, EITC, Veterans’ Benefits, etc.)	\$354 billion	18 percent
Miscellaneous receipts that offset spending (net of Medicare premiums)	\$-65 billion	-3 percent
Net interest	\$168 billion	8 percent

2. How much tax revenue is the federal government expected to collect in FY 2002?

In March, the Congressional Budget Office (CBO) estimated that total federal government revenues (including Social Security) would be \$1.942 trillion in FY 2002. This estimate consists of \$1.424 trillion in on-budget revenues (which exclude Social Security), and off-budget revenues of \$0.518 trillion. These figures include the budgetary effects of the economic stimulus package signed into law in March 2002. Since the March estimate, however, receipts in the crucial spring tax filing season have been much weaker than expected. For instance, total receipts in the month of April alone were \$94 billion lower than a year earlier.

3. What is the estimated budget deficit for FY 2002?

In July, the Administration's Office of Management and Budget (OMB) issued its Mid-Session Review, which includes the projected costs of Administration proposals. OMB projected a deficit for FY 2002 of \$165 billion (revised downward from its February projection of \$109 billion). OMB projected a deficit for FY 2003 of \$109 billion. CBO's August update will likely project a larger deficit than this for FY 2003.

This past March, in its latest official estimate, CBO projected the total budget deficit, including Social Security, to be \$46 billion for FY 2002. The off-budget surplus would be \$157 billion, due to a \$160 billion Social Security surplus (offset slightly by Postal Service net spending). The on-budget accounts, which exclude Social Security, would run a deficit of \$203 billion, after running a deficit of \$34 billion in FY 2001.

These CBO figures are baseline projections, which assume no change in policy (though they do include the effects of the stimulus bill that was already enacted into law). However, the budget outlook has worsened considerably since March. In its "Monthly Budget Review" of June 14, 2002, CBO stated that it "now expects the [total] deficit for the entire fiscal year to end up well above \$100 billion." CBO is scheduled to issue its updated figures by the end of August.

4. What are the CBO projections about deficits and surpluses over the next ten years?

Again, in March, CBO projected that the total budget (including Social Security) would improve from its \$46 billion budget deficit in FY 2002 to a \$40 billion deficit in FY 2003, a \$26 billion surplus in FY 2004, and subsequent surpluses rising to \$313 billion in 2010. Thereafter, assuming that last year's enacted tax cut was allowed to expire at the end of 2010, the surplus would jump to \$456 billion in 2011 and \$653 billion in 2012.

Excluding Social Security (and the Postal Service), the \$203 billion deficit of FY 2002 would worsen to a \$216 billion deficit in FY 2003, and then improve to a \$168 billion deficit in FY 2004, eventually reaching a \$26 billion surplus in 2010. The cumulative total surplus over 2003-2012 would be \$2.332 trillion; the cumulative on-budget (that is, non-Social Security and non-Postal Service) deficit would be \$150 billion. These figures include the budgetary effects of the economic stimulus package signed into law in March 2002.

The worsening of the budget outlook since March will surely impact the early years of the outlook in an adverse and significant way. CBO must estimate how this effect will carry forward to the later years.

5. Didn't last year's budget projections call for large surpluses? What happened?

Just one year ago, both CBO and OMB projected total budget surpluses of \$5.6 trillion over the ten fiscal years 2002-2011. However, the Administration proposed, and the Republican Congress enacted a tax cut costing \$1.7 trillion (including debt service) over 2001-2011 (assuming the tax cut's improbable sunset at the end of 2010). This tax cut exhausted virtually all of the non-Social Security, non-Medicare surplus over the first eight years of that budget window. The economy fell into recession, worsening the budget further.

However, more of an influence than the economy have been technical developments, perhaps driven by the falling financial markets, which have shown that the original surplus estimates were far too optimistic. These developments now indicate strongly that Democratic admonitions of caution before dissipating all of a projected surplus on a large tax cut were well founded. However, the Administration and the Republican Congress chose to ignore those admonitions, and the unfortunate results now appear likely to plague the country for years, and perhaps decades, to come.

6. Are Republican claims true that deficits are back because of the cost of September 11?

When the Administration assumed office, the unified surplus over the 2002-11 period was \$5.6 trillion. OMB now estimates it to be \$0.4 trillion, a decrease of \$5.2 trillion. The cost of responding to September 11 is approximately \$600 billion, or 12 percent of the total deterioration of the surplus. This estimated cost includes the \$40 billion emergency supplemental bill enacted last year, the airline bailout bill, the USA PATRIOT Act, and the victims compensation bill. It also assumes the enactment of the 2002 supplemental, the doubling of homeland security funding above pre-September 11 levels, establishment of the Department of Homeland Security, and more than \$20 billion per year for the Pentagon to conduct the war on terrorism.

By contrast, OMB's own estimate of the cost of the Bush tax cut, including interest, is \$1.5 trillion over the 2002-11 period. Thus, the enacted tax cut alone accounts for 29 percent of the deterioration of the surplus, according to OMB's most recent numbers. At the same time, the cost of responding to September 11 is no higher than 12 percent.

7. What is the estimated total federal debt?

In March, CBO estimated that federal debt held by the public would be \$3.355 trillion at the end of FY 2002 (excluding the effects of the economic stimulus package). However, this year's total federal deficit, which is the change in publicly held debt, is widely expected to be worse than expected, implying a higher debt as well.

8. What is the debt limit and why did it need to be raised in June 2002?

The statutory limit on federal debt, which applies to the sum of publicly held debt and securities held in government trust funds, is currently \$6.40 trillion. This spring, the Treasury Secretary avoided a breach of the statutory debt limit only by dis-investing the retirement trust funds for

federal employees. He announced that, even with such maneuvers, the statutory limit would have to be raised before June 28. In June, the Congress passed, and the President signed, a bill raising the debt limit from \$5.95 trillion to \$6.40 trillion.

The debt outlook has deteriorated significantly since last year because of the reappearance of budget deficits. Last year, the Administration projected that the statutory limit on debt would not be breached until 2008. However, with deficits again causing debt held by the public to grow rapidly (trust fund debt is essentially unchanged from previous projections), the government found itself facing the statutory debt limit this year.

9. How large is the estimated Social Security Trust Fund balance?

In March, the annual report of Social Security's trustees estimated that the Social Security Trust Fund would hold \$1.379 trillion in special Treasury securities at the end of calendar year 2002. These securities represent a standing legal claim on the U.S. Treasury to pay Social Security benefits in the future.

According to the most recent projections of the Social Security Trustees, the cost of Social Security benefits under current law will begin to exceed Social Security tax revenues in 2017. In 2027, the Social Security Trust Fund will begin to run an annual deficit, as the cost of benefits will exceed both Social Security revenues and interest earned on the bonds in the Social Security Trust Fund. By 2041, the bonds in the Social Security Trust Fund will have been exhausted, and the Social Security Trust Fund will be insolvent.

10. How does the budget account for the Medicare Trust Fund?

Under current law, the Medicare Trust Fund (Part A, or Hospital Insurance) is an on-budget account, unlike Social Security which by law is off-budget. Prior to this year, both parties had agreed that the Medicare Part A surplus, like the Social Security surplus, should not be available for tax cuts or new spending, and should be secured in a legislative "lockbox."

Unfortunately, the President's 2003 budget, like his 2002 budget, asserted that there is no Medicare surplus. Last year, OMB Director Mitch Daniels called the Medicare surplus "a hoax." In March 2002, CBO confirmed that the Bush tax cut forces the government to exhaust the Medicare Trust Fund surplus (\$329 billion) over the next 10 years (2002-2011).

11. What is the cost of Medicare?

In FY 2002, federal spending for Medicare benefits (net of premium receipts) is estimated to be \$223 billion. In 2003, CBO projects that the net cost of Medicare benefits will be \$233 billion. According to the 2002 Medicare Trustees Report, Medicare remains solvent until 2030 under current law. This is one year longer than the previous year's projection.

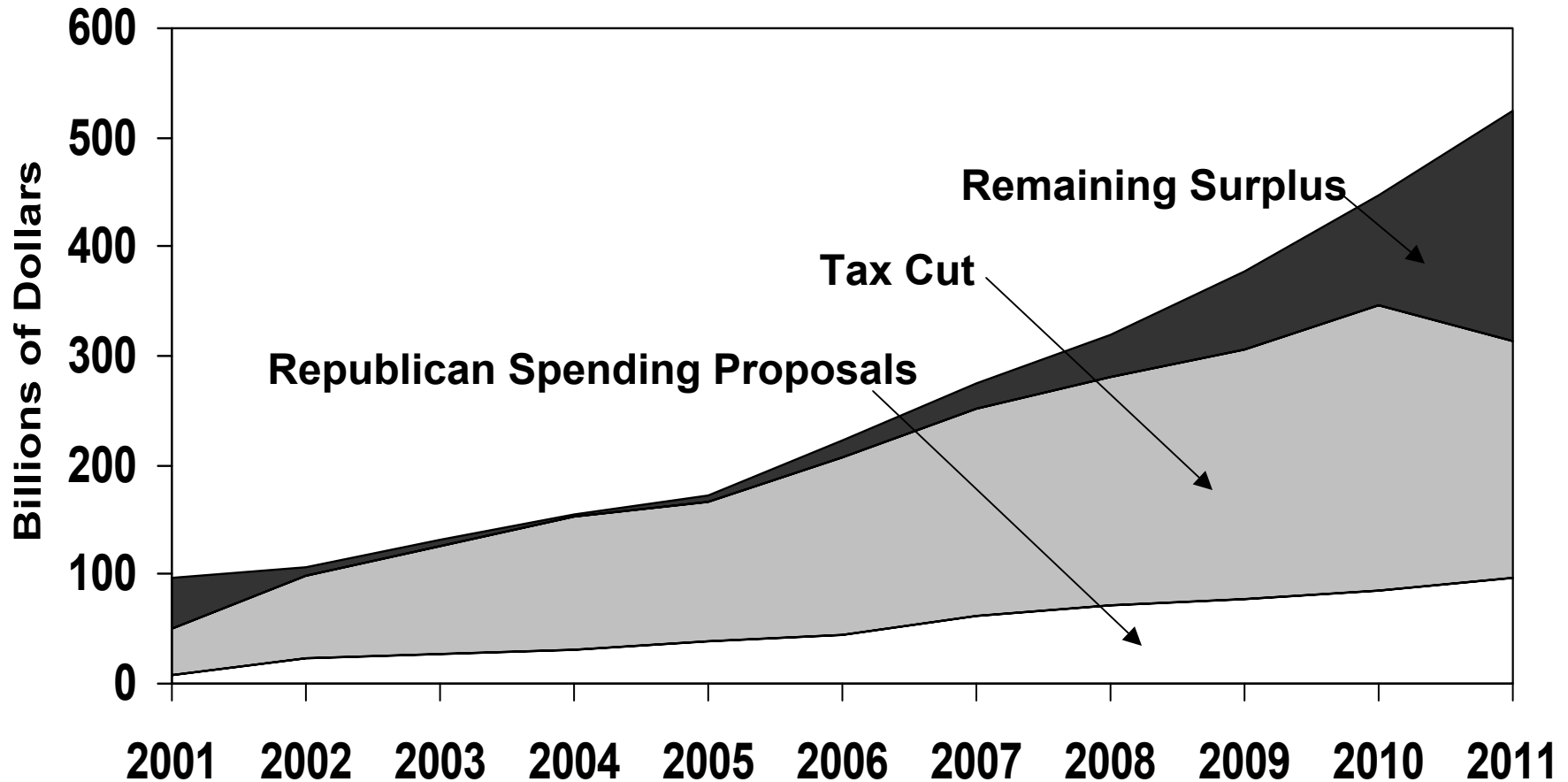
Chart Packet

Mid-Session Review

House Budget Committee Democrats
Congressman John Spratt
Ranking Member

Summer 2002

Last Year's Republican Budget Left No Margin for Error



April 2001 Projection of Non-Medicare, Non-Social Security Surplus;
Tax and Spending Proposals in Last Year's Republican Budget Resolution

\$5 Trillion Gone Under Republican Leadership

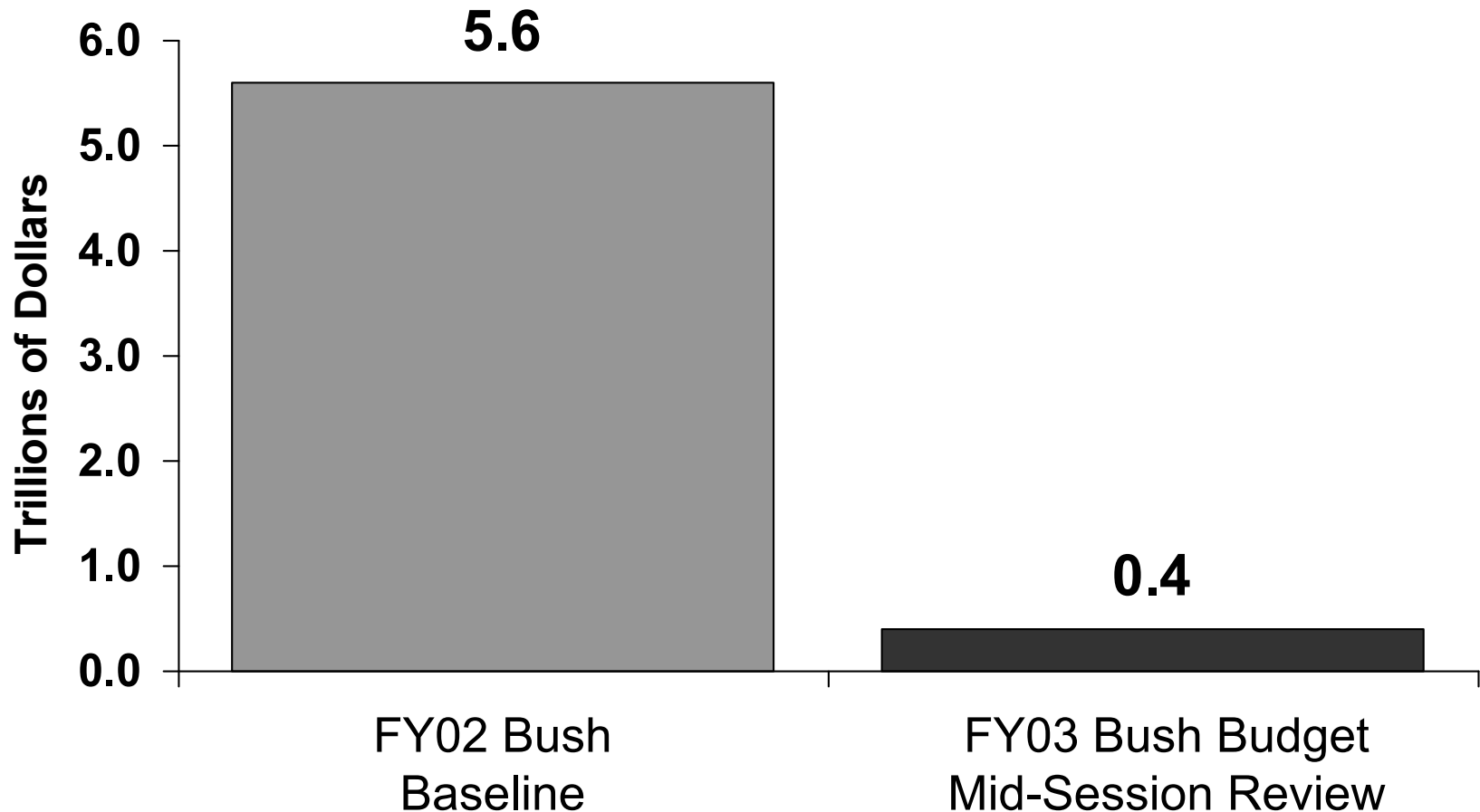
Unified Budget in Trillions of Dollars

	2002-2011
April 2001	5.637
August 2001	3.113
February 2002	0.661
July 2002	0.444

Source: Office of Management and Budget

From \$5.6 Trillion to \$444 Billion in One Year

Total Unified Surplus, 2002-2011



From Surplus to Deficit in Non-Social Security Budget

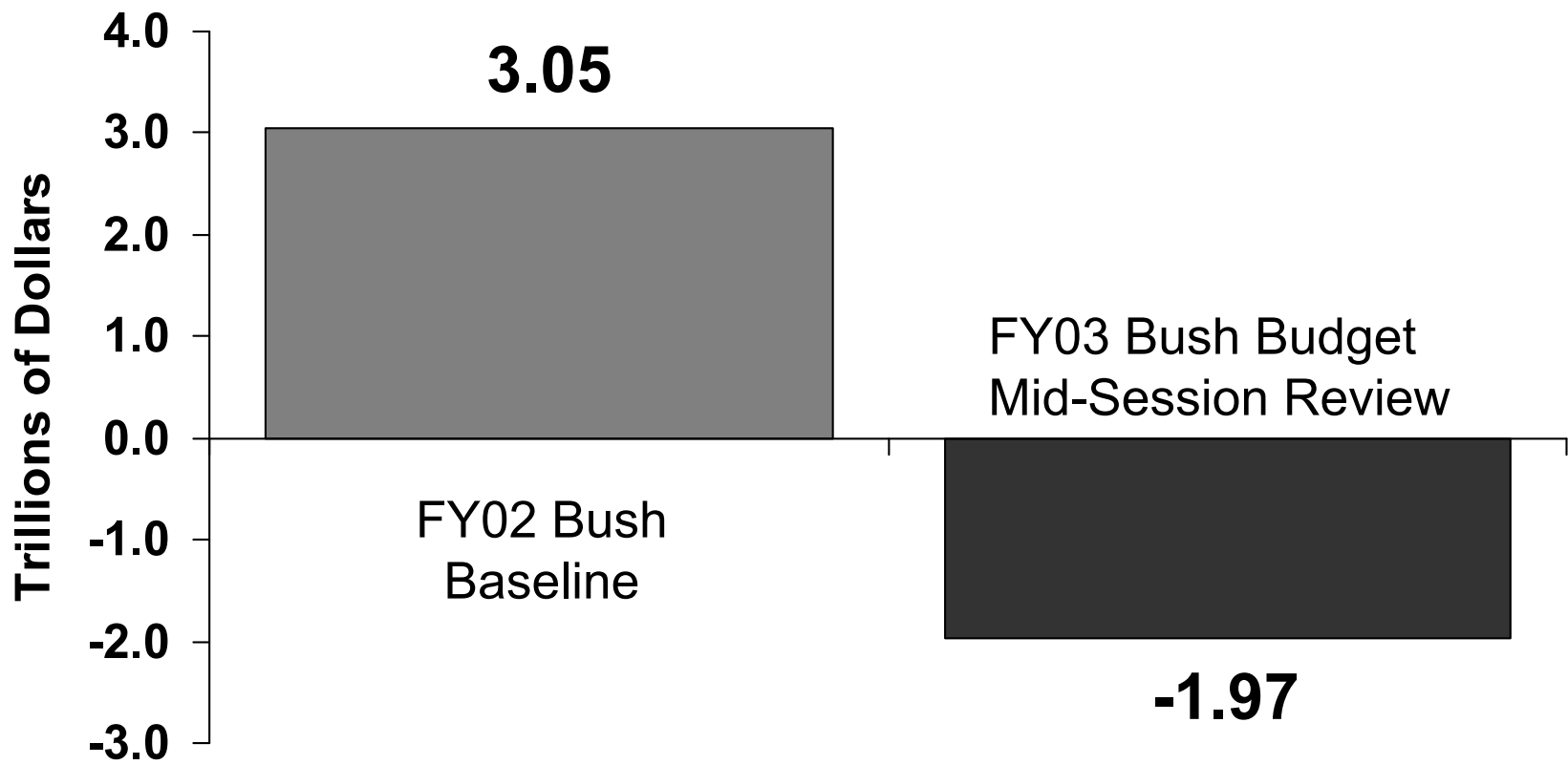
Trillions of Dollars

	2002-2011
April 2001	3.046
August 2001	0.575
February 2002	-1.650
July 2002	-1.968

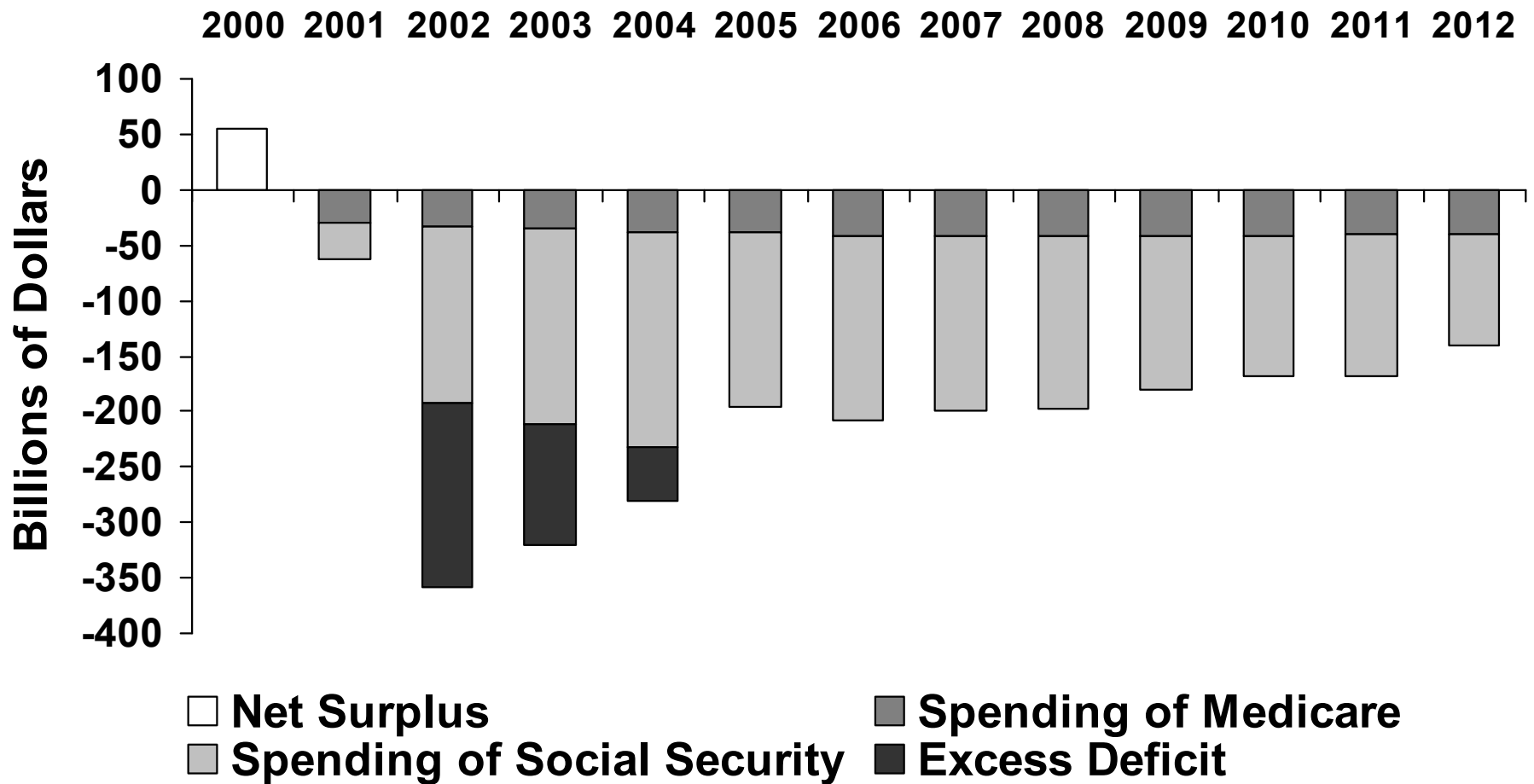
Source: Office of Management and Budget

Republicans Spend the Social Security Surplus

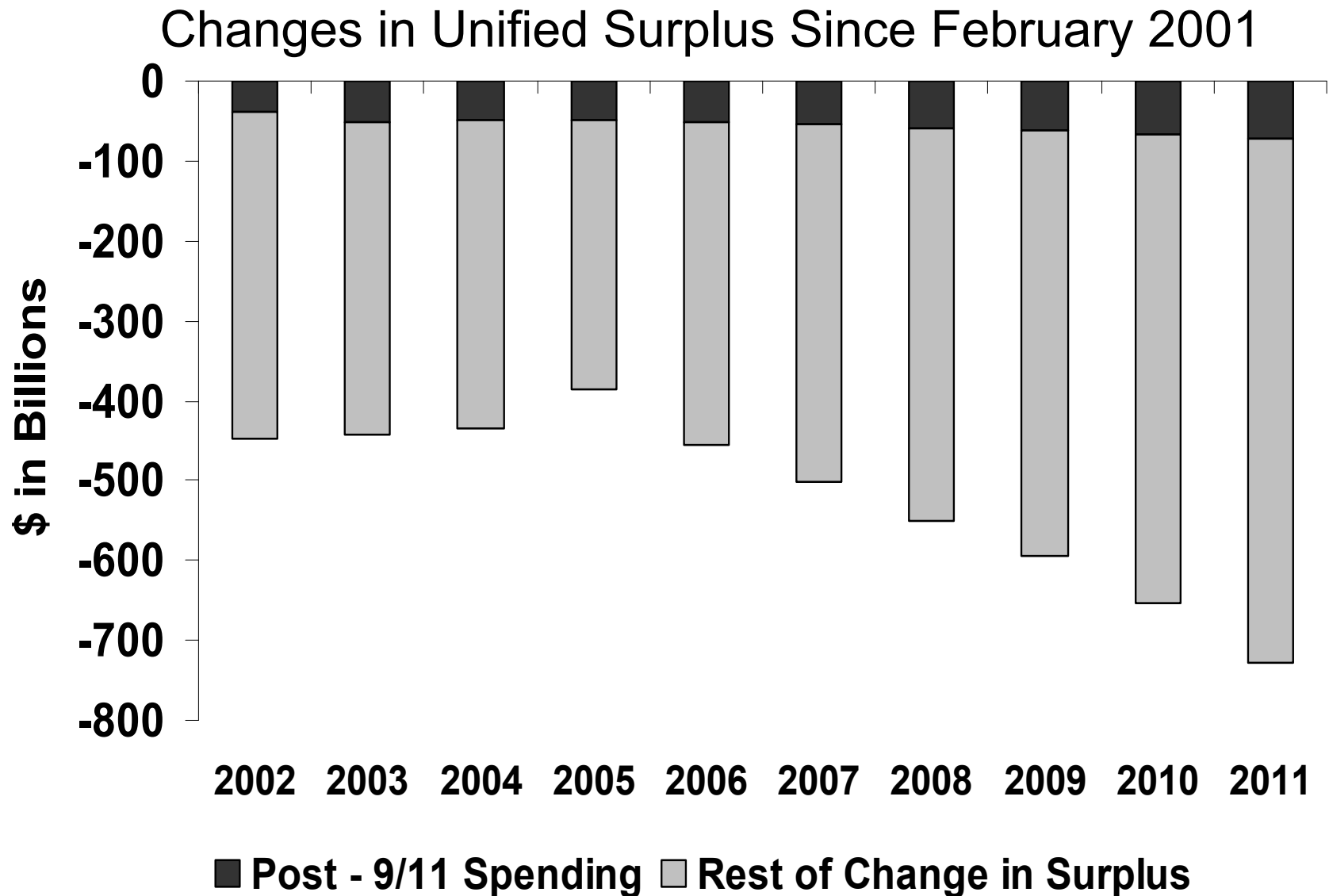
Total Non-Social Security Surplus, 2002-2011



President's Budget Spends Social Security and Medicare



Gauging the Impact of September 11:

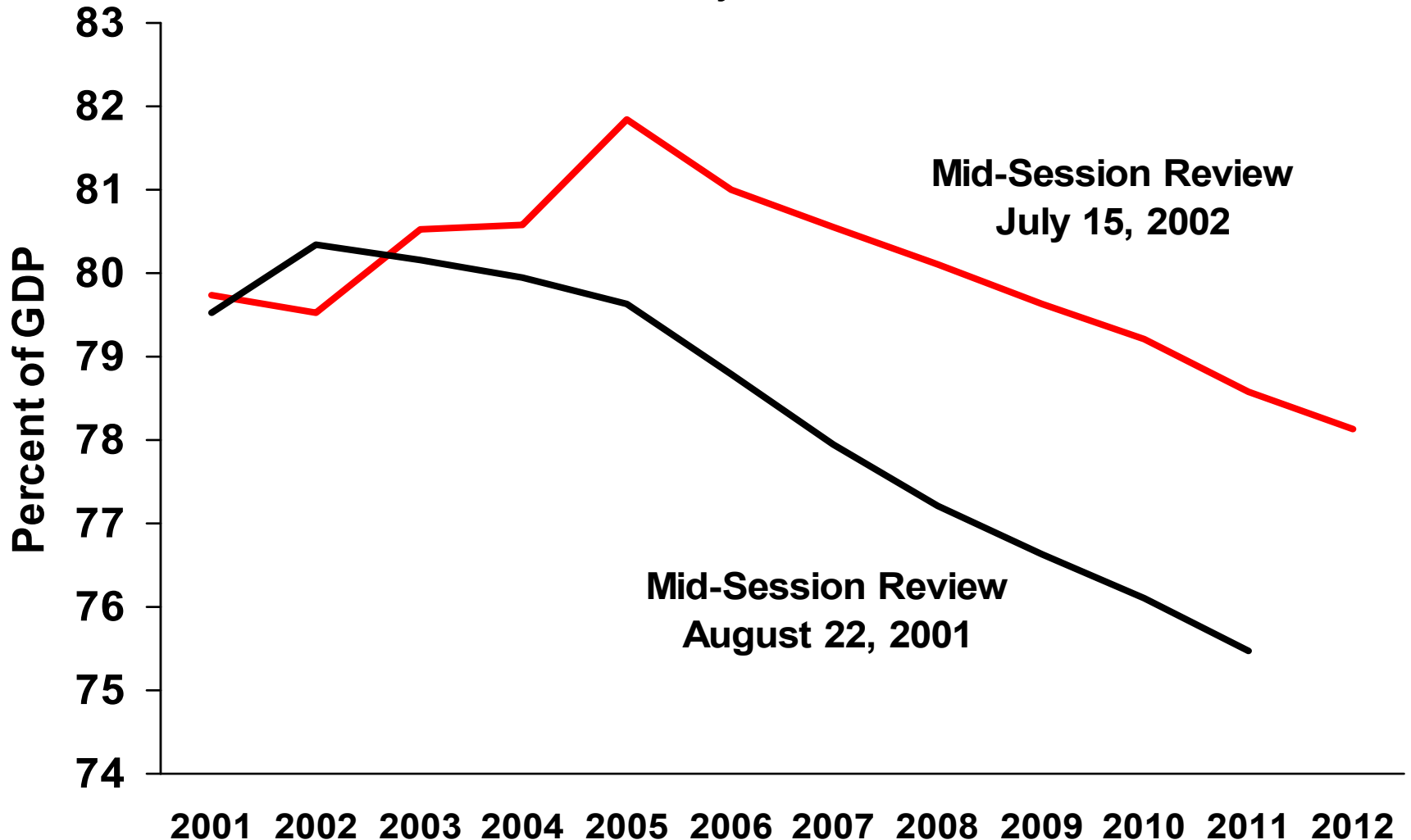


The Mid-Session Review Numbers Are Not Credible

- Optimistic GDP growth
- Higher share of GDP assumed taxable
- Medicare baseline more optimistic than CBO
- Omitted fix of AMT and extension of expiring tax benefits
- Assumed expiration of depreciation benefit in 2004
- Omitted extra cost of House Medicare Rx bill
- Omitted costs of President's proposed spending increases
- Omitted costs of natural disasters

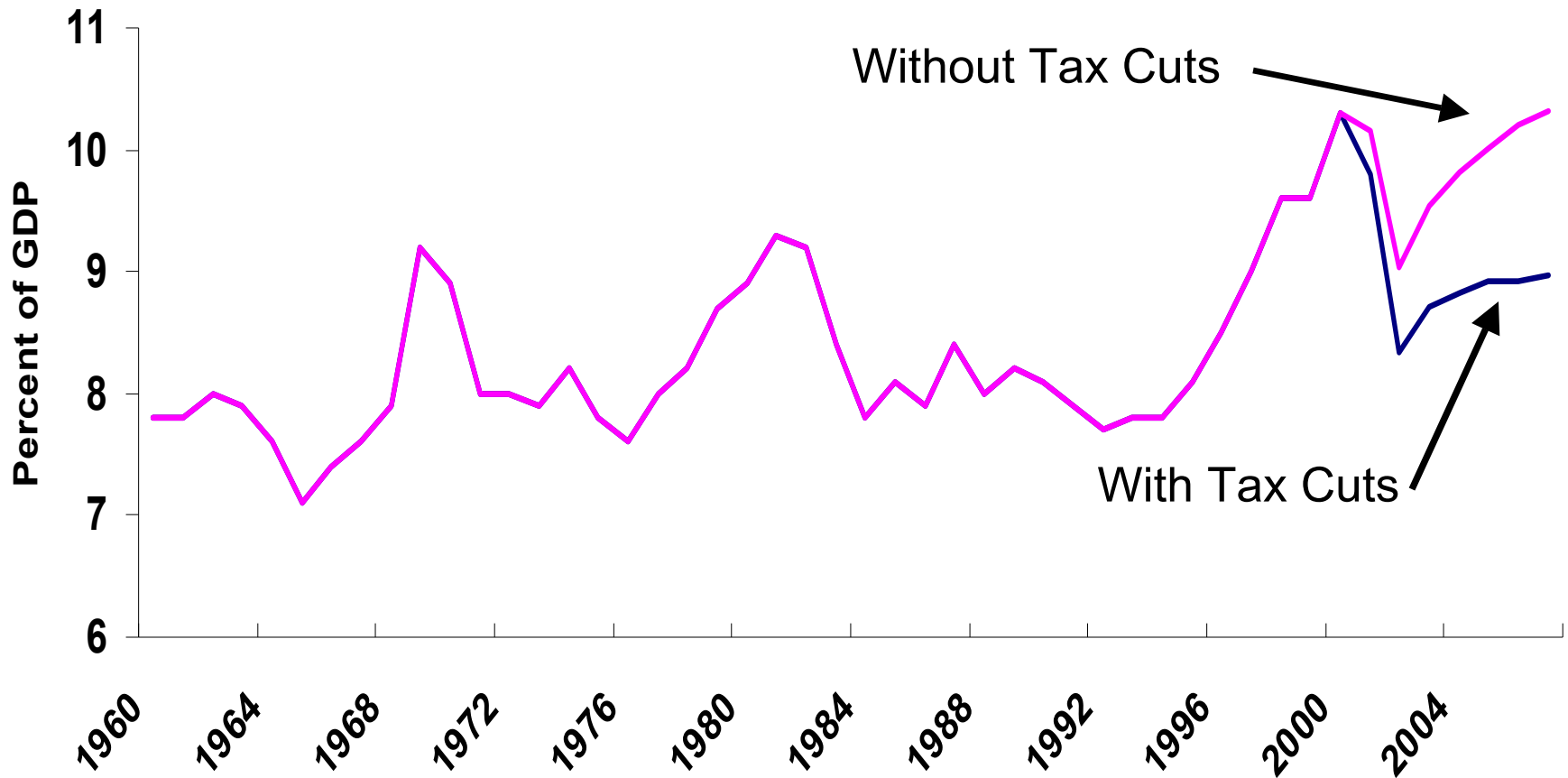
Taxable Portion of GDP

OMB Projections



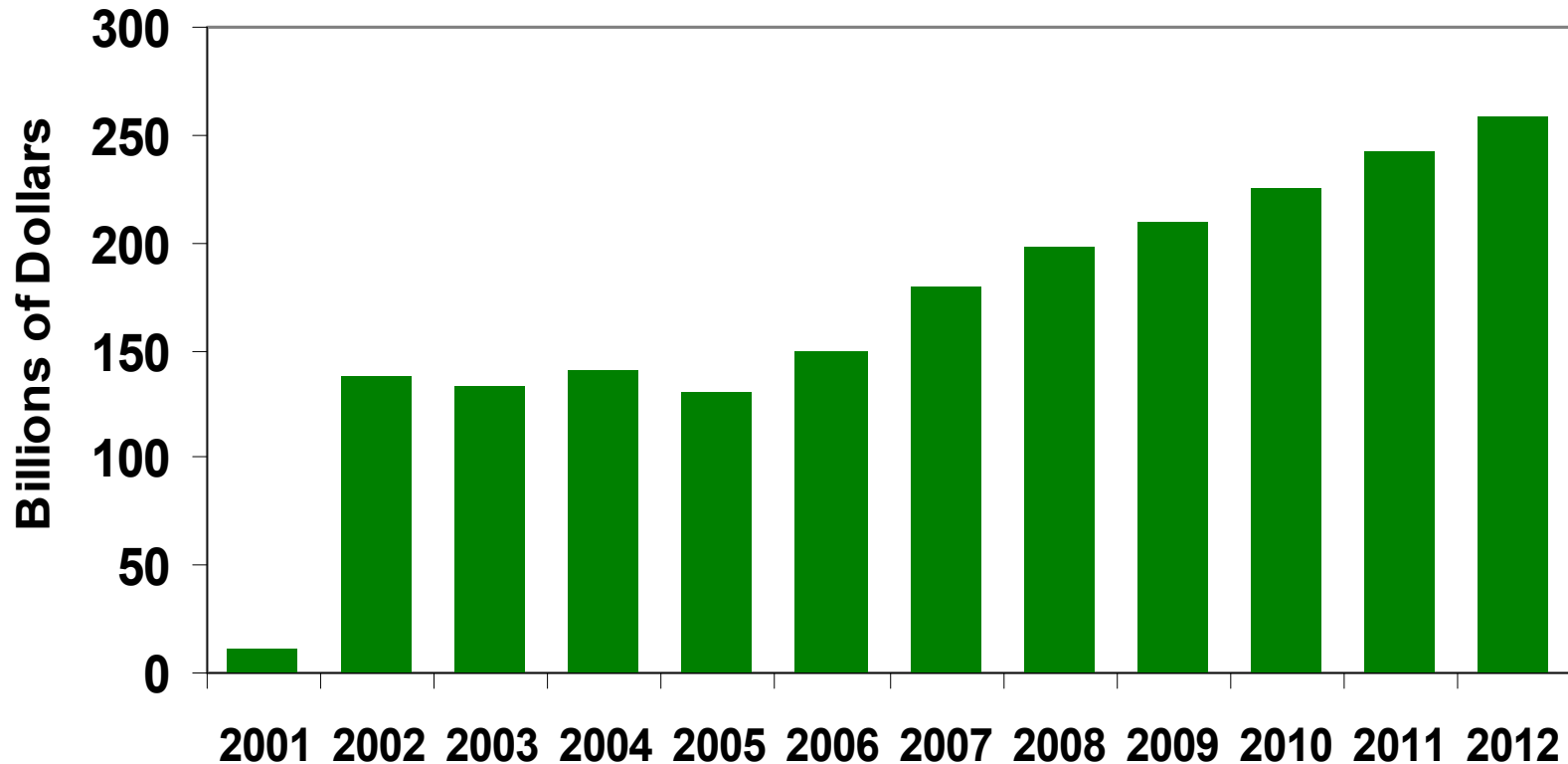
Administration Revenue Outlook Still Rosy

Individual Income Tax Revenues



OMB Projects Higher GDP

**Difference Between OMB's Current GDP
Projection and February 2002 Projection**



OMB Mid-Session Review:

Percent Change in Appropriations, 2002-03

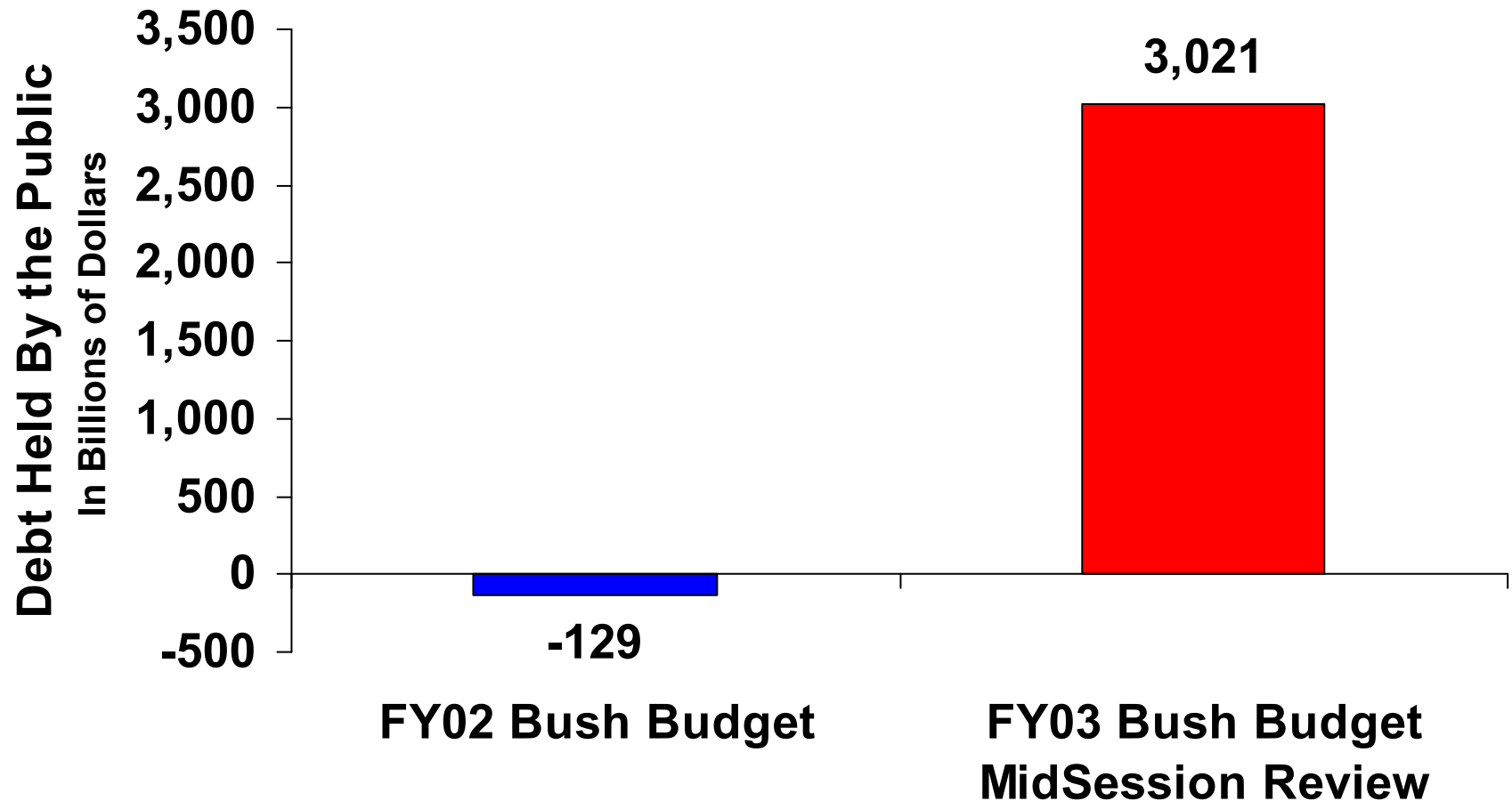
(dollars in billions)

	2002	2003	% change
Total Discretionary Budget Authority	688	757	10%
minus Defense	328	376	15%
minus Homeland Security	12	25	111%
= Other Gov't Operations	348	356	2%
minus International	24	25	5.1%
plus Transportation	41	33	-19.7%
= Domestic Appropriations	364.9	363.6	-0.4%

Pending and Prospective Tax Reduction 2003-2012

New Tax Proposals in Mid-Session Review (OMB)	141
Tax Extenders in Mid-Session Review (OMB)	62
Repeal of 2010 Sunset (OMB)	338
<hr/>	
President's Mid-Session Review Subtotal	541
Make Permanent Stimulus Bill Depreciation (JCT)	245
AMT: Extension of 2001 Provision (CBO)	139
AMT: Hold Harmless for 2001 Enacted Tax Cuts (JCT/HBC)	127
AMT Hold Harmless at Current Incidence (HBC)	150 - 250
Other Tax Extenders (CBO)	166
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Missing Pieces Subtotal	827 – 927
Grand Total	1,368 – 1,468

From Debt-Free to \$3.0 Trillion in Debt in 2011



Budget Deterioration To Date

